D. T. Seay - J. A. McCullough

TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1924

No. 352

UNITED STATES FIDELITY & GUARANTY COMPANY, PLAINTIFF IN ERROR,

vs.

A. P. WOOLDRIDGE, RECEIVER OF THE NATIONAL BANK OF CLEBURNE

IN ERROR TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

FILED APRIL 4, 1924

(30,244)

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OFFICE OF THE CLERK,

Supreme Court of the United States,

Washington, D.C.

April 30, 1925.

United States Fidelity & Guaranty Co., Plaintiff in Error,		
vs.		No. 362.
Wooldridge, Receiver, Defendant in Error.		

AUTHORITIES FOR PLAINTIFF IN ERROR.

Merchants Mutual Auto Liability Ins. Co. vs. Smart. 69 Lawyers Ed. 363.

AUTHORITIES FOR DEFENDANT IN ERROR.

Cosgrave vs. McKasey. 65 Minn. 426.
31 C. J. 437.
Jefferson vs. Tunnell. 2 Del. Ch. 135.
Tyree vs. Kirkham, Exr. 66 Ala. 424.
Walker vs. McKay. 59 Ky. 294.

[illegible]

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INDEX

JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., DECEMBER 4, 1924

[fol. 1] [CAPTION—Omitted]

[fol. 2] **IN UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF TEXAS, DALLAS DIVISION THEREOF**

No. —. At Law

A. P. WOOLDRIDGE, Receiver of the National Bank of Cleburne, Texas, Plaintiff,

vs.

UNITED STATES FIDELITY & GUARANTY COMPANY, Defendant

PETITION—Filed April 14, 1922

To the honorable judge of said Court:

Comes now A. P. Wooldridge, Receiver of The National Bank of Cleburne, Texas, and hereinafter styled and called Plaintiff, complaining of the United States Fidelity & Guaranty Company, hereinafter styled and called Defendant, and for cause of action respectfully represents and shows to this Honorable Court, as follows, to-wit:

I

Your plaintiff represents and shows to this Honorable Court, that at this time, and for many years prior hereto, he was, and is, a resident and citizen of Travis County, State of Texas, living in the City of Austin, Texas. Your plaintiff says, however, that at this time he is staying temporarily, or spending part of his time in Cleburne, Johnson County, State of Texas, in the performance of his duties as Receiver of the National Bank of Cleburne, Texas.

[fol. 3] II

Your plaintiff with respect shows to this Court that the defendant herein, the United States Fidelity & Guaranty Company, at this time, and at all the times alleged and set forth in this petition was, and is, a resident and citizen of the State of Maryland, with its principal office in the City of Baltimore, Maryland, but doing business, however, in the State of Texas, and having a permit at all the times herein mentioned and described to do business within the State of Texas, and maintains an office in the American Exchange Bank Building in the City of Dallas, County of Dallas, State of Texas. Plaintiff says in this connection that the said defendant herein, the United States Fidelity and Guaranty Co. at all the times herein mentioned, wrote and issued and was engaged in the business of writing and issuing insurance policies of various kinds, and policies insuring against dishonest acts of employes of banks and otherwise.

III

Your plaintiff further represents and shows to this Honorable Court, that on October 17th, 1921, and for many years prior thereto, the National Bank of Cleburne, Texas, was a National Bank, doing business and having its banking house and place of business in the City of Cleburne, Johnson County, State of Texas. Your plaintiff says that the said National Bank of Cleburne, Texas, on October 17th, 1921, and long prior thereto, as heretofore stated, was a banking corporation, and plaintiff says that the said The National Bank of Cleburne, Texas, was duly and legally incorporated as a National [fol. 4] Bank, under and by virtue of the laws of the United States of America, pertaining to and governing the incorporation, operating and controlling of National Banks, and your plaintiff says that the said National Bank of Cleburne, Texas, was such on or about October 17th, 1921, and for many years prior thereto.

IV

Your plaintiff, with respect, further represents and shows to this Honorable Court, that on or about the 17th day of October, 1921, that The National Bank of Cleburne, Texas, became wholly and notoriously insolvent, and did, on the 17th day of October, 1921, fail and close its doors for business, and eased to do business as a banking institution on said 17th day of October, 1921, and that said Bank, that is, The National Bank of Cleburne, Texas, has not been open as a banking institution since said time, except under the supervision and direction of your plaintiff herein, or the supervision of the Comptroller of Currency of the United States of America. Your plaintiff says that on said 17th day of October, 1921, and for some days prior thereto, that the said National Bank of Cleburne, Texas, was wholly and notoriously insolvent, and could not meet and pay any of its obligations, and at this time is not able to do so, and will not be able to do so at any time in the future.

V

Your plaintiff further shows to this Honorable Court, that on or about November 1st, 1921, that your plaintiff herein was duly and legally in every manner and way, appointed Receiver of the National Bank of Cleburne, Texas, by the Comptroller of Currency of the United States of America. Your plaintiff says that on or about [fol. 5] said November 1st, 1921, that the Comp-roller of Currency, in accordance with the laws of the United States of America, governing National Bank and pertaining to the appointment of Receivers for National Banks, that the said Comptroller of Currency of the United States of America, did duly and legally appoint your plaintiff herein Receiver of The National Bank of Cleburne, Texas, and your plaintiff says, that heretofore that he has duly qualified in every manner and way as Receiver of The National Bank of

Cleburne, Texas, and that since on or about November 1st, 1921, that he has been acting as Receiver of The National Bank of Cleburne, Texas, and is now Receiver for The National Bank of Cleburne, Texas, and as such Receiver and acting under the authority of the Comptroller of Currency of the United States of America that your plaintiff is winding up the affairs of The National Bank of Cleburne, Texas, and is winding same up as Receiver thereof.

VI

Your plaintiff further represents and shows to this Honorable Court, that by reason of the above and foregoing facts, that he is an Officer and Agent of the United States Government, and of the United States of America, and that as such Receiver he is such Officer and Agent of the United States of America, and of the United States Government, and that it is your plaintiff's duty, under the laws of the United States of America, pertaining to National Banks, and to the Receiverships of National Banks to close up and wind up the affairs of the National Bank of Cleburne, Texas, and to bring any and all suits necessary for the purpose of protecting the rights of The National Bank of Cleburne, Texas, and the creditors thereof, and to [fol. 6] recover for the said The National Bank of Cleburne, Texas, any amounts due it. Your plaintiff says that by reason thereof, and by reason of the fact that he is an Officer and Agent of the United States Government, and of the United States of American, that he is authorized to bring and maintain this suit in this Honorable Court.

VII

Your plaintiff further shows to this Honorable Court, that on or about the 28th day of August, 1921, that the defendant herein, while doing business in the State of Texas did issue to the National Bank of Cleburne, Texas, a Banker's Blanket Bond, for the sum of Twenty-Five Thousand ($25,000.00) Dollars; said Bond being No. 29016-21, the said The National Bank of Cleburne, Texas, paying the said defendant herein the premium of $1,250.00 for the issuing of said bond. Your plaintiff says that in consideration of the said The National Bank of Cleburne, Texas, paying the said $1,250.00, to the defendant herein, and which was paid on or about the said 28th day of August, 1921, by The National Bank of Cleburne, Texas, to the Defendant herein, that the said defendant did then issue its bond hereinbefore mentioned, by which bond its was agreed that the defendant herein undertook and agreed to indemnify The National Bank of Cleburne, Texas, and hold it harmless from and against any loss to an amount not exceeding $25,000.00 for loss of any kind or character, brought about through any dishonest act of any of the employes, wherever committed, that is; employes of The National Bank of Cleburne, Texas. Plaintiff says that said Bond issued by the defendant herein to The National Bank of Cleburne, Texas, in part, provided as follows:

[fol. 7] "(a) Through any dishonest act of any of the employes, wherever committed, and whether committed directly or by collusion with others;

(b) Through robbery; burglary, theft, hold-up, destruction or misplacement, while the property is within any of the insured's offices covered hereunder, whether effected with or without violence, or with or without negligence on the part of any of the employes;

(c) Through robbery, hold-up or theft, by any person whomsoever, while the property is in transit within twenty miles of any of the offices covered hereunder and in the custody of any of the employes, or through negligence on the part of any of the employes having custody of the Property while in transit as aforesaid."

Plaintiff says that by reason of the above and foregoing facts, and by reason of the provisions and stipulations above set forth, and which were contained in said bond, that it was agreed between the defendant herein, and The National Bank of Cleburne, Texas, that the said defendant would pay to, indemnify and reimburse The National Bank of Cleburne, Texas, an amount not exceeding $25,-000.00, through any dishonest act of any of the employes of The National Bank of Cleburne, Texas, wherever the same was committed and whether committed directly or through collusion with others, and whether committed through robbery, burglary, theft, hold-up, destruction or misplacement, while the property was within any of the offices or buildings of The National Bank of Cleburne, Texas.

VIII

Your plaintiff with respect further represents and shows to this [fol. 8] Honorable Court that said Bond, herein mentioned and described, was executed on or about the 28th day of August, 1921, and was to be in full force and effect for a period of one year from the said 28th day of August, 1921, and your plaintiff says that from August 28th, 1921, up until the close of the National Bank of Cleburne, Texas, and thereafter, that said Bond issued to The National Bank of Cleburne, Texas, by the defendant herein, was in full force and effect, and plaintiff says that the term and life of said Bond was for one year, that is: twelve (12) months from the 28th day of August, 1921.

IX

Your plaintiff further represents and shows to this Honorable Court, that in said Bond herein mentioned and executed and issued by the Defendant herein to The National Bank of Cleburne, Texas, that it was agreed as follow:

"The Underwriter hereby undertakes and agrees to indemnify the insured and hold it harmless from and against any loss, to an amount not exceeding Twenty-Five Thousand and No/100 Dollars ($25,000.00), of money, currency, bullion, bonds, debentures, scrip,

certificates, warrants, transfers, coupons, bills of exchange, promissory notes, checks or other similar securities, hereinafter referred to as Property in which the insured has a pecuniary interest or for which it is legally liable, sustained by the insured subsequent to noon of the date hereof and while this bond is in force and discovered by the Insured subsequent to noon of the date hereof and prior to the expiration of twelve months after the termination of this bond as provided in Condition II."

[fol. 9] Your plaintiff says that while said bond was in full force and effect, and after the 28th day of August, 1921, and on or before October 17th, 1921, that S. B. Norwood, President of The National Bank of Cleburne, Texas, and who was President of the said The National Bank of Cleburne, Texas, all during the year 1921, up until the failure of said Bank, that the said S. B. Norwood, through dishonest acts on his part, and by theft, embezzlement and through his acts, fraudulently and dishonestly took from the offices and buildings, and fraudulently and dishonestly, and by theft, robbery and embezzlement, took from the National Bank of Cleburne, Texas, more than $25,000.00 worth of money, currency, bullion, bonds, debentures, scrips, certificates, warrants, transfers, coupons, bills of exchange, promissory notes, checks and other similar securities which was the property of The National Bank of Cleburne, Texas, and in which the said The National Bank of Cleburne, Texas, at said time, had a pecuniary interest in, and also for which the said The National Bank of Cleburne, Texas, was legally liable, and your plaintiff says that the said S. B. Norwood took the same and committed the acts herein mentioned and described, after the 28th day of August, 1921, and before the 17th day of October, 1921, and while said bond herein mentioned was in full force and effect, and your plaintiff says that the acts of the said S. B. Norwood herein mentioned come within the terms of the bond herein mentioned and described, and are fully covered in every manner and way by the provisions of said bond, issued by the defendant herein to The National Bank of Cleburne, Texas, bearing date of August 28th, 1921. Your plaintiff further says that during the times that the said S. B. Norwood committed the acts herein mentioned, and herein' fore described, that he was [fol. 10] President of The National Bank of Cleburne, Texas, and was an employe of said The National Bank of Cleburne, Texas, within the terms and provisions of said bond issued by the defendant herein to The National Bank of Cleburne, Texas, and your plaintiff says that the said S. B. Norwood, in the manners and ways hereinbefore described and mentioned, took much more than $25,000.00 of money, currency, bullion, bonds and other property, hereinbefore mentioned and described, but the exact amount that the said S. B. Norwood took, in the manner and way hereinbefore described is not known to your plaintiff at this time, but that the said S. B. Norwood did take much more than $25,000.00, and your plaintiff says that after the execution of the bond in question, and before the 17th day of October, 1921, the said S. B. Norwood as President of The National Bank of Cleburne, Texas, and as an

employe of The National Bank of Cleburne, Texas, that the said S. B. Norwood did in the manner and way hereinbefore alleged and set forth, take the property hereinbefore alleged and set forth from the National Bank of Cleburne, Texas, in the manner and way hereinbefore alleged and set forth, in an amount exceeding $25,000.00.

X

Your plaintiff further represents and shows to this Honorable Court that — this time he is not able to say whether or not the said S. B. Norwood did the things herein mentioned, directly or by collusion with others, but your plaintiff does say and charge that the said acts were done not only directly by the said S. B. Norwood at the times and places herein mentioned, but also in collusion with others, but whose names this plaintiff is at this time unable [fol. 11] to give and set forth, but all of which is known or should be known to the defendant herein. Your plaintiff says, that the said property hereinbefore mentioned and described and which the said S. B. Norwood took and carried away, or disposed of dishonestly and wrongfully and fraudulently, was not the property of the said S. B. Norwood, and he had no interest therein, but that the same was the property of your plaintiff herein, or at least, your plaintiff had a pecuniary interest therein or was legally liable for the same.

XI

Your plaintiff further represents and shows to this Honorable Court, that the bond herein mentioned and described was in full force and effect at the times herein mentioned and described, and at the times, and all the times that the said S. B. Norwood committed and did the things alleged and set forth herein. Your plaintiff further says that The National Bank of Cleburne, Texas, in every manner and way, while it was a going concern, complied with the terms and provisions of the bond issued to it by the said defendant herein, and your plaintiff says that the said defendant herein has been notified, and has full notice and knowledge of the loss sustained by The National Bank of Cleburne, Texas, through the acts of the said S. B. Norwood, and your plaintiff says that proof of loss has been duly and legally made to the said defendant herein, and that in fact the defendant herein has accepted liability on the bond in question, for the full penal sum of $25,000.00, and your plaintiff says that said bond on the part of The National Bank of Cleburne, Texas, and on the part of your plaintiff as Receiver of said The National Bank of Cleburne, Texas, has been fully complied with in every manner and way.

[fol. 12] XII

Your plaintiff further represents and shows to this Honorable Court, that by reason of the above and foregoing facts, that the

said defendant herein is liable on said bond in the sum of $25,000.00, as provided by the terms of said bond, and your plaintiff says that as Receiver of The National Bank of Cleburne, Texas, that he brings this suit and is entitled to maintain this said suit to recover from the defendant herein the said sum of $25,000.00, with interest thereon at the legal and lawful rate, if it be held and found that your plaintiff is entitled to interest, from the date that said $25,000.00 should have been paid, and your plaintiff says that he has made demand on the defendant herein for the payment of same, but that the defendant has not in whole or in part paid said $25,000.00, or any interest thereon, but while admitting the same is due declines to pay the same, and your plaintiff says that he therefore brings this suit to recover the same.

XIII

Your plaintiff further represents and shows to this Honorable Court, that at the times herein mentioned the defendant herein mentioned was a foreign corporation, doing business in the State of Texas, and plaintiff says that the defendant herein has an Agent upon whom service of citation can be had, which Agent is within the jurisdiction of this Court, and for the Dallas Division thereof, and your plaintiff says that the defendant herein is within the jurisdiction of this Honorable Court, and for the Dallas Division thereof.

[fol. 13]

XIV

Your plaintiff further represents and shows to this Honorable Court that John F. Scott, of Houston, Harris County, Texas, has been designated by the United States Fidelity & Guaranty Company, the defendant herein, as their attorney or Agent, in Texas, for the service of citation or summons, and your plaintiff says, that the defendant herein can be served by serving the said John F. Scott. Plaintiff further says that Ernest A. Robbins, Manager of the defendant company, residing in Dallas, Dallas County, Texas, can be served herein.

Wherefore, your plaintiff herein prays that the defendant be cited herein as provided for by law in such cases made and provided, for the May Term of this Honorable Court, and that upon the hearing and trial hereof, that your plaintiff herein in the capacity he sues herein do have and recover of and from the defendant herein the sum of $25,000.00 and interest, if it be held and determined that your plaintiff is entitled to recover interest, for all of which your plaintiff prays and for all other relief that your plaintiff may show himself entitled to in law and under the facts herein.

Thompson, Barwise, Wharton & Hines, Attorneys for Plaintiff, A. P. Wooldridge, Receiver of the National Bank of Cleburne, Texas.

[fol. 14] IN UNITED STATES DISTRICT COURT

[Title omitted]

ANSWER—Filed April 28, 1922

Now, at this time, comes the defendant and demurs to plaintiff's petition herein and says that the same is insufficient in law and shows no cause of action against this defendant.

Seay, Seay, Malone & Lipscomb, Attorneys for Defendant.

1. For answer herein, the defendant denies all and singular the allegations in plaintiff's petition contained and demands strict proof of the same.

2. Further answering herein, this defendant would show to the Court that on or about the 24th day of August, 1921, this defendant became the surety upon the bond of the said National Bank of Cleburne as principal, said bond or indemnity agreement being payable to the Gulf, Colorado and Santa Fe Railway Company in the sum of Fifty Thousand ($50,000.00) Dollars, the condition of which said bond or agreement of indemnity was that said bank should pay to the said railway company on demand all sums of money then [fol. 15] or thereafter deposited by the said railway company with said National Bank of Cleburne; that this obligation was to run, and did run, from the 24th day of August, 1921, to the 24th day of August, 1922, a copy of which said agreement or bond of indemnity is attached hereto, marked exhibit "A," and made a part of this answer.

3. This defendant would further show to the Court that, as alleged by the plaintiff herein, on or about the 17th day of October, 1921, the National Bank of Cleburne, Texas, became wholly and notoriously insolvent and did, on the 17th day of October, 1921, fail and close its doors for business and ceased to do business as a banking institution on said 17th day of October, 1921, and has not opened as a banking institution since that time, except under the supervision and direction of the plaintiff herein as Receiver, or the supervision of the Comptroller of the Currency of the United States of America, and at said time, as alleged by plaintiff, said bank could not meet and pay off its obligations, and at this time is not able to do so and will not be able to do so in the future.

4. This defendant further alleges that it is true, as stated by the plaintiff, that on or about November 1st, 1921, the plaintiff herein was duly and legally in every manner appointed Receiver of the National Bank of Cleburne by the Comptroller of the Currency of the United States of America and that said plaintiff on or about said 1st day of November, 1921, was in accordance with the laws of the United States of America, by the Comptroller of the Currency appointed Receiver of said National Bank of Cleburne, and that said plaintiff has heretofore duly qualified in every manner

[fol. 16] and way as the Receiver of the National Bank of Cleburne and that since on or about November 1st, 1921, has been acting as such Receiver and is now acting as Receiver for said bank.

5. This defendant further shows to the Court that it is true that on or about the 28th day of August, 1921, this defendant, while doing business in the State of Texas, with a legal permit from said State to do so, did issue to the said National Bank of Cleburne a banker's bond for the sum of Twenty-five thousand ($25,000.00) Dollars, the said bond being numbered 29016-21 and a copy of which is hereto attached, marked exhibit "B," and made a part hereof.

6. This defendant further shows to the Court that it is true, as alleged by plaintiff, that after the 28th day of August, 1921, and prior to October 17th, 1921, one S. B. Norwood was president of the National Bank of Cleburne, Texas, and who was president up until the failure of said bank, did, through dishonest acts on his part and by theft, embezzlement and through such acts, fraudulently and dishonestly take from the offices and buildings and fraudulently and dishonestly, and by theft, robbery and embezzlement, took from the said National Bank of Cleburne, more than Twenty-five Thousand ($25,000) Dollars' worth of money, currency, bullion, bonds, debentures, scrip, certificates, warrants, transfers, coupons, bills of exchange, promissory notes, checks and other similar securities which was the property of the National Bank of Cleburne, Texas, and in which said National Bank of Cleburne, Texas, at said time had a pecuniary interest and also for which said National Bank of Cleburne, Texas, was legally liable, and that said acts were committed by said Norwood after the 28th day of August, 1921, and before said 17th day of October, 1921, and that [fol. 17] as a direct and proximate result of the acts and conduct of said Norwood, and the taking by him of said enormous sums of money and other valuable property of said bank, that said bank, as alleged by the plaintiff herein, was compelled to close and did close its doors and went into the hands of a receiver as by the plaintiff alleged, and that as a direct result of said acts of said Norwood, it was unable to pay, is now unable to pay, and will never be able to pay its depositors in said bank.

7. That at the time of said conduct and acts of said Norwood, and at the time of the failure of said bank, the said Gulf, Colorado and Santa Fe Railway Company did have on hand in said bank as a depositor therein the sum of Twenty-three Thousand, Three Hundred and Twelve ($23,312.51) and 51/100 Dollars, and that under and by virtue of said acts of said Norwood and the closing of the said bank and the appointment of the Receiver thereof, said National Bank of Cleburne was unable, is now unable and always will be unable to pay its said depositors; that by virtue of having executed said bond for said National Bank of Cleburne as its surety, this defendant was requested to pay, as said surety, and did as said

bank's surety, pay to said Gulf, Colorado and Santa Fe Railway Company the said sum of Twenty-three Thousand, Three Hundred and Twelve ($23,312.51) and 51/100 Dollars, on or about the 16th day of January, 1922, and that as a matter of law it was then and there subrogated to all the rights or claims that the said Gulf, Colorado and Santa Fe Railway Company had or might have against said bank, and that in addition thereto, on or about January 24th 1922, the said Gulf, Colorado and Santa Fe Railway Company did assign to this defendant all of its right, title and interest [fol. 18] in and to all claims, rights or demands against said bank and that subsequently, to-wit, on or about February 1st, 1922, said claim and assignment were filed with and approved by the plaintiff, A. P. Wooldridge, Receiver of the National Bank of Cleburne, Texas, all of which is fully set out in a copy of same hereto attached and marked exhibit "G" and made a part hereof, which said claim is and has been due this defendant since the payment thereof to said Gulf, Colorado and Santa Fe Railway Company, and is now due and payable to this defendant.

8. This defendant would show to the Court that it has always been willing and has endeavored to pay to the plaintiff herein the difference between plaintiff's claim against this defendant of Twenty-five Thousand ($25,000.00) Dollars and this defendant's set-off or counterclaim against the plaintiff of Twenty-three Thousand, Three Hundred and twelve ($23,312.51) and 51/100 Dollars, and would have tendered said money in legal tender but for the fact that the plaintiff herein indicated and advised that he would not accept said difference in settlement of said bank's claim against this defendant.

Wherefore, this defendant prays that said set-off be allowed this defendant and that judgment be entered against it for the sum of One Thousand, Six Hundred and Eighty-seven ($1,687.49) and 49/100 Dollars in full and complete satisfaction of its liability to the plaintiff herein. It further respectfully asks for all other relief to which it may be justly entitled herein.

Seay, Seay, Malone & Lipscomb, Attorneys for Defendant.

[fol. 19] Exhibit "A"

33095-21. $50,000.00

State of Texas,
County of Johnson:

Know all men by these presents, that the National Bank of Cleburne, as principal, and the United States Fidelity and Guaranty Company, Baltimore, Maryland, as sureties, are held and firmly bound to pay to the Gulf, Colorado and Santa Fe Railway Company, at its office in the City of Galveston, County of Galveston, State of Texas, the sum of Fifty Thousand ($50,000.00) Dollars, — payment

whereof well and truly to be made, we bind ourselves, our heirs, executors, administrators, successors and assigns, firmly by these presents.

The condition of this obligation is such that if the said principal shall pay on demand to said Railway Company all sums of money now or hereafter deposited by said Railway Company with said principal or to the credit of said Railway Company with said principal, or which may in any manner or for any reason be now or at any time hereafter due or payable by said principal to said Railway Company, then this obligation shall be void, otherwise it shall remain in full force and effect.

Any failure of the Railway Company to give notice to said sureties of anything concerning the business or affairs or conditions of said principal shall not release said sureties of the obligation hereof.

The term of this bond begins on the 24th day of August, 1921, and ends on the 24th day of August, 1922. This bond may be continued for any subsequent period by Continuation Certificate, signed and sealed by the Surety.

[fol. 20] The Surety may terminate this bond at any time prior to default on giving fifteen days' notice in writing to the Obligee, after which time all liability hereunder shall cease.

In witness whereof, we have executed these presents this the 24th day of August, 1921.

National Bank of Cleburne, by S. B. Norwood, Its President, Principal. United States Fidelity & Guaranty Company, by E. A. Robbins, Attorney-in-Fact, Surety.

Attest: —— ——.

Exhibit "B" to Answer

United States Fidelity and Guaranty Company of Baltimore, Maryland

No. 29016-21. $25,000.00.

Banker's Blanket Bond

(Approved by the Insurance Committee of the American Banker's Association)

In consideration of the premium of One Thousand, Two Hundred Fifty ($1,250.00) Dollars, paid by The National Bank of Cleburne, Cleburne, Texas, hereinafter referred to as Insured, to the [fol. 21] United States Fidelity and Guaranty Company, Baltimore, Maryland, hereinafter referred to as the Underwriter, for the period of one year from the date hereof, and of subsequent annual premiums, each premium being based upon the total number of the Insured's officers, clerks and other employes, employed at the Insured's office covered hereunder at the beginning of the year for which such premium is paid, (all the officers, clerks, and other employes

employed at the offices covered hereunder during the currency of this bond being hereinafter referred to as employes,) the Underwriter hereby undertakes and agrees to indemnify the Insured and hold it harmless from and against any loss, to an amount not exceeding Twenty-five Thousand ($25,000.00) Dollars, of money, currency, bullion, bonds, debentures, scrip, certificates, warrants, transfers, coupons, bills of exchange, promissory notes, checks or other similar securities, hereinafter referred to as property in which the Insured has a pecuniary interest or for which it is legally liable, sustained by the Insured subsequent to noon of the date hereof and while this bond is in force and discovered by the Insured subsequent to noon of the date hereof and prior to the expiration of twelve months after the termination of this bond as provided in Condition II.

(a) Through any dishonest act of any of the employes, where-ever committed, and whether committed directly or by collusion with others;

(b) Through robberty, burglary, theft, hold-up, destruction or misplacement, while the Property is within any of the Insured's offices covered hereunder, whether effected with or without violence, or with or without negligence on the part of any of the employes;

[fol. 22] (c) Through robbery, hold-up or theft, by any person whomsoever, while the Property is in transit within twenty miles of any of the offices covered hereunder and in the custody of any of the employees, or through negligence on the part of any of the employes having custody of the property while in transit as aforesaid.

The forgoing agreement is subject to the following conditions and limitations:

1. The offices of the Insured which are covered hereunder are located as follows: Cleburne, Texas.

If the Insured shall give to the Underwriter notice that it desires any other office to be covered hereunder and shall give the location thereof and the number of officers, clerks, and other employes therein, then, if the Underwriter shall give its written consent thereto, such office shall be covered hereunder, from and after the receipt of such notice, and an additional premuim shall be paid; but no notice to the Underwriter of an increase during any premium year in the number of employes at any of the offices covered here-under need be given and no additional premium need be paid, unless such increase shall result from the merger or combination with the Insured or another banking institution.

2. This bond does not cover:

(a) Any loss directly or indirectly effected by means of forgery, unless the forgery be committed by, or with the collusion of, one or more of the employes.

[fol. 23] (b) Any loss resulting from insurrection, riot, civil commotion, or military or usurped power, or from an earthquake, volcanic eruption, or similar disturbance of nature.

(c) Any loss resulting from the acts or act of any of the Directors of the Insured other than those employed as salaried officials.

(d) Any loss the result of any loan made by the Insured or by any of the employes, whether authorized or unauthorized, unless such loan be made with intent on the part of such employes to defraud the Insured.

(e) Shortages in the tellers's cash due to error, and any such shortage not in excess of the normal shortage in the bank, shall be deemed to be due to error

3. No statement made by or on behalf of the Insured, whether contained in the application or otherwise, shall be deemed to be a warranty of anything except that it is true to the best of the knowledge and belief of the person making the statement.

4. The Insured shall give to the Underwriter written notice of any loss hereunder as soon as possible after the Insured shall learn of such loss, and within ninety days after learning of such loss shall file with the Underwriter an itemized proof of claim duly sworn to.

5. The value of any securities for the loss of which claim shall be made hereunder shall be determined by the average market value of such securities on the day preceding the discovery of such loss. [fol. 24] If such securities have no quoted market value, their value shall be determined by agreement or by arbitration.

6. No action or proceeding shall be brought under this bond in regard to any loss, unless begun within twelve months after the Insured shall learn of such loss, or in case such limitation be void under the law of the place governing the construction hereof, then within the shortest period of limitation permitted by such law.

7. In case of recovery, whether made by the Insured or the Underwriter, on account of any loss hereunder, from any source other than insurance or surety-ship, the net amount of such recovery, less the actual costs and expenses of making same, shall be applied to reimburse the Insured in full for such loss, and the excess, if any, shall be paid to the Underwriters; and the Insured shall execute all necessary papers to secure to the Underwriter the rights herein provided for.

8. The amount of this bond shall not be reduced by any payment on account of any act resulting in a loss hereunder, except as to other acts committed prior to the giving by the Insured to the Underwriter of notice of such loss; provided, however, that in no event shall the Underwriter be liable on account of any one loss or series of losses caused by the acts or omissions of any employe or combination of employes, or caused by the same casualty or event, for a greater amount than that specified in the first paragraph hereof as the pen-

alty of this bond; and provided further that the Insurer shall pay to the Underwriter, upon demand, an additional premium, computed pro rata upon the sum so paid, from the date of such notice to the end of the current premium year.

[fol. 25] 9. If the Insured shall, in the application for this bond, state its intention to carry fidelity suretyship upon any of the employes, and shall, in the computation of the premium for this bond, receive credit for such suretyship, then, in case a loss shall be sustained through the dishonest act of any employe covered, or stated to be covered, by such fidelity suretyship, the Underwriter shall be liable hereunder only for that part of such loss which is in excess of the amount of the fidelity suretyship carried or stated to be carried on such employe.

10. If the Insured shall hold, as indemnity against any loss covered hereunder, any valid enforceable security, other than the fidelity suretyship, if any, for which credit has been given in accordance with the preceding section, the Underwriter shall be liable hereunder only for such proportion of such loss as the amount of this bond bears to the aggregate amount of this bond and such other security.

11. This bond shall terminate—(a) thirty days after the receipt by the Insured of a written notice from the Underwriter of its desire to terminate this bond, or (b) upon the receipt by the Underwriter of a written request from the insured to terminate this bond. This bond shall terminate as to any employe—(a) as soon as the Insured shall learn of any refault hereunder committed by such employe, or (b) fifteen days after the receipt by the Insured of a written notice from the Underwriter of its desire to terminate this bond as to such employe.

Signed, sealed and dated this 28th day of August, 1921.
United States Fidelity and Guaranty Company.

[fol. 26] The following rider attached:

(Rider to be attached to all new bonds issued or effective on and after April 22, 1921, on Forms 218 and 256; and to be attached at the next premium anniversary date on and after May 22, 1921, to all bonds issued on forms 113, 119, 121, 127, 176, 218, 209, 219, 245, 256:)

Rider 264

Rider to be Attached to and Form a Part of Bankers' Blanket Bond Number 29016-21, Dated August 28, 1921

Executed by United States Fidelity and Guaranty Company in the amount of ($25,000.00) Twenty-five Thousand and No/100 Dollars and in favor of The National Bank of Cleburne.

It is understood and agreed that the above described bond is hereby amended (said amendment to become effective as of the date hereof) as follows:

First. By eliminating paragraph C of Condition 2 and substituting in lieu thereof the following:

(c) "Any loss resulting directly or indirectly from any act or acts of any director of the Insured, other than one employed as a salaried official, or of any partner of the Insured."

Second. By adding to Condition 2 a new paragraph, as follows:

"Any loss through larceny or theft committed by any person to whom any Employee shall have, otherwise than through dishonesty, [fol. 27] delivered Property or extended credit."

Third. By adding to Condition 2 a new paragraph, as follows.

"Any loss of money and/or securities the nominal value and description of which have not been ascertained by the Insured before loss; nor for any loss of money and/or securities contained in customer's safe deposit boxes."

Signed, sealed and dated this 28th day of August, 1921.
United States Fidelity and Guaranty Company, by —— ——,
Attorney-in-Fact.

The undersigned, the insured under above described bond, hereby agrees to accept the terms of this amendment as part of said bond.

—— ——.

EXHIBIT "C" TO ANSWER

The National Bank of Cleburne, Cleburne, Texas

Receiver's Certificate of Proof of Claim

No. One. Cleburne, Texas, January 16, 1922.

This is to certify that Geo. N. Yard, Treasurer, has this day made legal and satisfactory proof that Gulf, Colorado and Santa Fe Rail- [fol. 28] road is a creditor of the National Bank of Cleburne, Cleburne, Texas, in the amount of Twenty-three Thousand, Three Hundred Twelve Dollars and Fifty-one Cents, upon the following claim, to-wit:

	Dollars, cents
Balance due on open account subject to check—Liability #917	22,992.74
Balance due upon interest bearing account—Liability #—	....
Interest due on said interest bearing account—Liability No. —..	....
Certificate of deposit No. —, issued by The National Bank of Cleburne, Cleburne, Texas as —Liability No. —..	....
Certificate of deposit No. —, issued by The National Bank of Cleburne, Texas, as—Liability No. —	....
Interest on certificate of deposit No. —, issued by the National Bank of Cleburne, Texas, Liability No. — ..	....
Interest on certificate of deposit No. —, issued by The National Bank of Cleburne, Texas, Liability No.	....
Unpaid draft No. —, issued by the National Bank of Cleburne, Texas, as, on —, Liability No. —	....
Protest fees on draft No. —, issued by The National Bank of Cleburne, Texas, on ——, —, ——	....
Liability No. —	....
Cashier's check No. 6832, issued by The National Bank of Cleburne, Cleburne, Texas, Liability No. 3098 ..	306.56
[fol. 29] Cashier's check No. 8808—Liability No. 3165..	13.21
Total	23,312.51

and Gulf, Colorado and Santa Fe Railroad, or the lawful assignee of this claim, will be alone entitled to the dividends thereon.

No assignment of this claim, or any portion thereof, will be recognized in the payment of dividends unless notice of such assignment is given to the Receiver and entered upon his books before such dividents are declared, as evidenced by his endorsement hereon. This certificate is to be surrendered to the Receiver upon the payment of the final dividend.

A. P. Wooldridge, Receiver of the National Bank of Cleburne, Cleburne, Texas.

Important.—Do not lose this certificate. It must be presented when each dividend is paid.

January 24, 1922.

For value received we hereby assign the within claim to the United States Fidelity and Guaranty Company.

Gulf, Colorado & Santa Fe Railway Co., by Geo. N. Yard, Treasurer.

Witness: John F. Scott.

Entered Feby. 1st, 1922. A. P. Wooldridge, Receiver.

[fol. 30] Dividends on within claim have been paid as follows:

First Dividend, — per cent., paid —— —, ——.
Second Dividend, — per cent., paid —— —, ——.
Third Dividend — per cent., paid —— —, ——.
Fourth Dividend,— per cent., paid —— —, ——.
Fifth Dividend, — per cent., paid —— —, ——.
Sixth Dividend, — per cent., paid —— —, ——.
Seventh Dividend, — per cent., paid —— —, ——.
Eighth Dividend, — per cent., paid —— —, ——.
Ninth Dividend, — per cent., paid —— —, ——.
Tenth Dividend, — per cent., paid —— —, ——.

(Indorsed:) The National Bank of Cleburne, Cleburne, Texas. Receiver's Certificate of Proof of Claim. No. —. $—. Name: —— ——.

In United States District Court

Supplemental Petition—Filed March 14, 1923

To the Honorable District Court of the United States for said District:

Comes now the plaintiff and for reply to the original answer of the defendant herein says:

1

That said answer is insufficient in law and shows no defense to plaintiff's cause of action, and the plaintiff accordingly prays judgment of the Court.

[fol. 31] 2

Plaintiff specially excepts to said answer and all the matters and things therein set out and says the same should be stricken out because the facts alleged fail to show any right whatever upon the part of the defendant to offset against the claim of plaintiff the claim the defendant has acquired as a result of the alleged transaction between defendant, The National Bank of Cleburne, and the Gulf, Colorado & Santa Fe Railway Company, the facts alleged being wholly insufficient to entitle the defendant to the offset defendant seeks to assert.

3

If further answer shall be required herein, plaintiff denies all and singular the allegations in defendant's said answer contained and demands strict proof thereof.

4

Further and specially replying to the matters and things set out in said answer of the defendant, the plaintiff would respectfully

show to the Court that defendant both as to its obligation in behalf of the Gulf, Colorado & Santa Fe Railway Company as alleged surety for the National Bank of Cleburne, and its obligation to the National Bank of Cleburne as surety on the bond of S. B. Norwood, former President of the said National Bank of Cleburne, was a paid surety having accepted compensation according to its schedules for becoming such surety in both instances, and then and now the said defendant was engaged in the business of undertaking such [fol. 32] service as surety on bonds of whatever character, including those involved in this litigation.

And in the undertaking with reference to the bond executed to indemnify the National Bank of Cleburne against the alleged wrongful acts of its President, the plaintiff avers that said bond became and is an asset of the bank and a trust fund for the purpose primarily of paying off and discharging, so far as it will, the liabilities of said Bank to its various creditors in exact proportion to their respective claims, and hence it would be unjust and inequitable to allow or permit said fund so established for said purposes to be diverted to the claim of one creditor, resulting in a preference to such creditor in violation of the terms and provisions of the laws of the United States.

And in this connection, plaintiff would further respectfully show to the Court that in addition to the liability of the said National Bank of Cleburne to the Gulf, Colorado & Santa Fe Railway Company as a creditor of and depositor in said bank, there were, at the time said bank closed its doors and at the time of the receivership of the same, as alleged by both plaintiff and defendant, a large number of creditors, including Johnson County, Texas, to which said County the said National Bank of Cleburne was a debtor to the extent of over $1,000,000.00 and that said bank at said time owed other depositors and creditors various and sundry amounts totaling an aggregate of over $2,000,000.00, and which amount said bank and the Receiver, plaintiff herein, will be wholly unable to pay excepting as hereinafter stated.

In this connection, plaintiff would respectfully show the Court further that after realizing on all the assets of the National Bank of Cleburne, including assessment of stockholders under the National [fol. 33] Banking Act, the collection of the bond sued on in this cause and realization of all other assets, plaintiff will be unable to pay the creditors of said bank exceeding 25 cents on the dollar of the amounts owing such creditors of said bank, hence it would be unjust and inequitable to permit or allow the defendant to offset the claim of the Gulf, Colorado & Santa Fe Railway Company and pay such claim in full, to the great detriment of the interest of all other creditors. But, if defendant is entitled to any subrogation at all, such right should be confined to sharing prorata in the assets of said bank with all other creditors, the same as the Gulf, Colorado & Santa Fe Railway Company would have had to share were it not for the bond of indemnity on which defendant was surety, and said defendant should not be permitted to occupy a higher position

than that occupied by said Railway Company, and pay off and discharge its liabilities of over $18,000.00 as represented by the two bonds, by a total payment of only $25,000.00, thereby escaping the obligation of its own contracts which it had undertaken for an adequate consideration.

Wherefore, plaintiff prays that it have judgment against defendant as originally prayed for, and that the alleged offset on behalf of defendant be denied, and that defendant as to such offset be adjudged to occupy the position of a creditor, and no better position than that which would have — occupied by the creditor whose claim the said defendant has paid.

Thompson, Barwise, Wharton & Hiner, Ellis Douthit, Attorneys for Plaintiff.

[fol. 34] STIPULATION WAIVING A JURY—Filed March 14, 1923

Agreement

It is agreed by and between the parties to this cause that a jury shall be waived, and that the cause shal' be submitted to the Court on the pleadings and agreement enter into between the parties hereto.

Thompson, Barwise, Wharton & Hiner, Attorneys for Plaintiff. Seay, Seay, Malone & Lipscomb, Attorneys for Defendant.

IN UNITED STATES DISTRICT COURT

[Title omitted]

STIPULATION RE STATEMENT OF FACTS—Filed March 17, 1923

Come now the parties plainti' and defendant in this cause, and except as hereinafter modified, ag e that the facts set forth in the plaintiff's original petition and th defendant's answer are true and correct, and that the sole question for the determination of the Court is as to whether or not under the facts alleged, the defendant [fol. 35] company is entitled as against the plaintiff to set off the demand it holds as assignee or subrogee of the Gulf, Colorado & Santa Fe Railway Company.

The foregoing agreement is to also cover the additional facts alleged in plaintiff's First Supplemental Petition, and which facts shall modify the defendant's answer to the extent that the averment in said answer indicating that said National Bank of Cleburne will be unable to pay any of its creditors anything, shall be taken to mean that said bank will be able, through its Receiver under the National Banking Act, to pay its creditors not less than ten per cent

(10%) and not exceeding twenty-five — (25%) of their obligations; otherwise, the facts as alleged in the original petition and the answer of the defendant, and the supplemental petition of the plaintiff, are to be taken as true and correct, and the cause submitted to the Court on such petition, answer and supplemental petition, excepting only as modified by this agreement.

Thompson, Barwise, Wharton & Hiner, Ellis Douthit, Attorneys for Plaintiff. Seay, Seay, Malone & Lipscomb, Attorneys for Defendant.

[fol. 36] In United States District Court

Judgment—Flied March 17, 1923

On this day this cause was called for trial, and both parties being represented by their attorneys, a jury having been waived in writing, and the parties having agreed as to the facts, which agreement is on file among the papers in this cause, all matters of law under the pleadings and agreement were submitted to the Court, and the Court after hearing the pleadings, agreement as to the facts, and the argument of counsel, is of the opinion that the law is for the plaintiff.

It is accordingly ordered, adjudged and decreed that the plaintiff, A. P. Wooldridge, duly appointed and acting Receiver under the laws of the United States, of the National Bank of Cleburne, Texas, do have and recover of and from the defendant, the United States Fidelity & Guaranty Company, the sum of $25,000.00, together with interest thereon at the rate of six per cent per annum from January 1, 1922, until paid, together with all costs in this behalf expended, for all of which execution may issue.

It is further ordered, adudged and decreed that the set off alleged in defendant's answer be denied, and that as to said set off and cross action the defendant take nothing, to which judgment and decree the defendant then and there in open Court excepted.

Wm. H. Atwell, Judge United States District Court for the Northern District of Texas.

[fol. 37] In United States District Court

[Title omitted]

Assignment of Error—Filed April 20th, 1923

Comes now the United States Fidelity & Guaranty Company, the defendant in the foregoing action, and in connection with its petition for a writ of error makes the following assignment of error, which it avers occurred upon the trial of the above cause, to-wit:

The Court erred in rendering judgment for the plaintiff and in refusing to allow the set-off plead by the defendant, in that the undisputed facts show that on the 24th day of August, 1921, the United States Fidelity & Guaranty Company, (defendant) became surety upon the bond of the National Bank of Cleburne, which said bond or agreement of indemnity was payable to the Gulf, Colorado & Santa Fe Railway Company in the penal sum of Fifty Thousand Dollars ($50,000), the condition of which was to the effect that the bank would pay to the Railway Company on demand all sums of money then or thereafter deposited by said Railway Company with said bank. This bond ran for one year from the 24th day of August, 1921. That a few days thereafter, to-wit, on the 28th day of August, 1921, the United States Fidelity & Guaranty Company issued its bankers' bond for the sum of Twenty-five Thousand Dollars ($25,000) to the said National Bank of Cleburne, insuring it against the dishonest act of any of the employees of said bank wherever committed. This bond ran for a period of one year from August 28, 1921.

[fol. 38] It is further an admitted fact that on and after the 28th day of August, 1921, and until October 17, 1921, one S. B. Norwood was President of the National Bank of Cleburne, and was President until the 17th day of October, 1921, when said bank failed as the direct and proximate result of the acts and conduct of said Norwood, and the taking by him of enormous sums of money and other valuable property of the bank in a sum exceeding Twenty-Five Thousand Dollars ($25,000), and that as a result of said conduct of said Norwood the bank was compelled to close its doors and went into the hands of a receiver, the plaintiff herein. That by virtue, of said acts of said Norwood said bank is unable to pay, and will never be able to pay, not less than ten per cent nor more than Twenty-five per cent of its obligations to its depositors.

That at the time of the failure of the bank and the passing into the hands of the receiver on October 17, 1921, the said Gulf, Colorado & Santa Fe Railway Company had on deposit in said Bank the sum of Twenty-Three Thousand, Three Hundred, Twelve and 51/100 Dollars ($23,312.51), which said bank at said time was unable to pay and did not pay; that as a result of the United States Fidelity & Guaranty Company (defendant) having executed the bond for said bank as its surety it was requested and required by said Railway Company to pay, and by virtue of said bond and being surety of said bank did pay, on the 16th day of January, 1922, to said Railway Company, the sum of Twenty-Three Thousand, Three Hundred Twelve and 51/100 Dollars ($23,312.51); and on the 24th day of January, 1922, said Railway Company did assign to the United States Fidelity & Guaranty Company (defendant) all its right, title and interest to all claims, rights or demands against said bank. On February 1, 1922, such assignment was filed with and approved by the plaintiff, A. P. Wooldridge, Receiver of said bank, being admitted to be correct in amount.

[fol. 39] That said judgment of the Court in refusing to allow the set-off of this defendant, is, as above shown, contrary to law and the

admitted facts, in that this defendant is solvent, and the plaintiff is insolvent, and that the potential, incidental or contingent liability on defendant's part to pay to the plaintiff on the bankers' bond, and the bank's reciprocal, potential, incidental or contingent liability to the defendant herein by virtue of its execution of the bond to one of its depositors, to-wit, Gulf, Colorado & Santa Fe Railway Company, came into existence several months prior to the insolvency of said bank, and further that the liability of one to the other arose out of the same transaction, to-wit, the infidelity of said President Norwood, and that actual liability against both the bank and the Company in their respective favors arose simultaneously when the bank closed. The United States Fidelity & Guaranty Company (defendant) was thus at the time and in the manner and amount indicated, subrogated to all the rights that the depositor, Gulf, Colorado & Santa Fe Railway Company, had, and thus standing in said depositor's shoes this defendant was entitled to off-set the bank's claim against it by the amount paid to the bank's depositor, and in refusing to allow said off-set, said judgment, as above indicated, is contrary to law and the agreed facts in the case.

Seay, Seay, Malone & Lipscomb, Attorneys for United States Fidelity & Guaranty Company.

[fols. 40 & 41] Bond on Writ of Error for $30,000—Approved and filed April 20, 1923; omitted in printing

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[fol. 42] In United States Circuit Court of Appeals, Fifth Circuit

No. 4098

United States Fidelity & Guaranty Company, Plaintiff in Error,

versus

A. P. Wooldridge, Receiver of the National Bank of Cleburne, Defendant in Error

Error to the District Court of the United States for the Northern District of Texas

Opinion—Filed January 5th, 1924

Walter F. Seay (Seay, Seay, Malone & Lipscomb on the brief), for Plaintiff in Error.

G. W. Wharton and Ellis Douthit (Thompson, Barwise, Wharton & Hiner, and Ellis Douthit on the brief), for Defendant in Error.

Before Walker and Bryan, Circuit Judges, and Grubb, District Judge

WALKER, Circuit Judge:

On August 28, 1921, the plaintiff in error, (herein called the Guaranty Company), issued to the National Bank of Cleburne, (herein called the Bank), a so-called "Bankers' Blanket Bond" in the sum of $25,000.00, whereby the Guaranty Company agreed to indemnify the Bank and to hold it harmless from and against loss to an amount not exceeding $25,000.00 through any dishonest act [fol. 43] of any of the Bank's employees. A few days prior to the above mentioned date the Guaranty Company became the Bank's surety on a bond in favor of the Gulf, Colorado & Santa Fe Railway Company, the condition of that bond reading as follows:

"The condition of this obligation is such that if the said principal shall pay on demand to said Railway Company the sums of money now or hereafter deposited by said Railway Company with said principal, or to the credit of said Railway Company with said principal, or which may in any manner or for any reason be now or at any time hereafter due or payable by said principal to said Railway Company, then this obligation shall be void; otherwise, it shall remain in full force and effect."

The Bank paid the premiums on the above mentioned bonds. While each of those bonds was in force the President of the Bank defaulted in an amount greatly more than $25,000.00, with the result that the Bank became insolvent and unable to pay its depositors, and the defendant in error was appointed receiver of its assets. At the time of the Bank's failure it was indebted to the above mentioned Railway Company as a depositor in the sum of $23,321.51. In January, 1922, the Guaranty Company, in compliance with the demand of the Railway Company and the obligation of the bond to the latter, paid to the Railway Company the amount owing to it by the Bank; whereupon the Railway Company assigned to the Guaranty Company all claims, rights, or demands of the Railway Company against the Bank. Thereafter the Receiver brought this suit against the Guaranty Company on its above mentioned $25,000.00 bond to the Bank. The Guaranty Company claimed the right to set off against the $25,000.00 demand asserted by the Receiver the $23,321.51 demand of the Railway Company against the Bank, the right to which was assigned by the Railway Company to the Guaranty Company, which tendered as the [fol. 44] balance due on its $25,000.00 bond the amount of the difference between the amount of that bond and the amount paid by the Guaranty Company to the Railway Company. The court decided that the Guaranty Company was not entitled to the set off claimed by it.

The two above mentioned undertakings of the Guaranty Company were separate and distinct transactions. By the first above mentioned bond it became obligated to indemnify the Bank against

loss to an amount not exceeding $25,000.00 through any dishonest act of any of the Bank's employees. By the second above mentioned bond it became the Bank's surety to the extent stated for sums owing by the Bank to the Railway Company as a depositor. Under one of the Bonds the Guaranty Company's liability was to the Bank. The Railway Company was the beneficiary of the liability imposed on the Guaranty Company by the other bond. An effect of the Bank's failure as above stated was to fix the amount due from the Guaranty Company under each of its bonds, those amounts being $25,000.00 payable on the bond to the Bank and $23,321.51 payable on the bond to the Railway Company. The result of sustaining the asserted right of set-off would be to enable the Guaranty Company to satisfy debts aggregating more than $48,000.00 by paying only the amount of one of those debts, $25,000.00. That result cannot properly be reached on the ground that the Guaranty Company acquired, by the assignment mentioned or by subrogation, the right to have the amount due to the Railway Company as a depositor paid out of the amount due to the Bank on the bond payable to it. The Guaranty Company could not acquire from the Railway Company a right not possessed by the [fol. 45] latter. The Guaranty Company's liability on its bond to the Bank was an asset of the estate which the Receiver held in trust for all the creditors of the Bank. Upon the Bank's insolvency being established the Railway Company's claim, so far as the Bank's assets are concerned, gave it no more than the right to file its claim seasonably and share ratably in the disposition of those assets; and the Guaranty Company, by its transaction with the Railway Company after the Bank's insolvency was established, acquired no other or higher right than the Railway Company had when it so parted with its claim. Oates v. Smith, 57 So. 438; 25 R. C. L. 1377. The forbidden result of a preferential payment out of the insolvent Bank's assets of an unpreferred debt owing by it cannot be brought about by one who is indebted to the Bank acquiring, after the establishment of its insolvency, a claim against the Bank and using that claim as a set off against the debt owing to the Bank. The right to set off is governed by the state of things existing at the moment of insolvency, and not by conditions thereafter created. Yardley v. Philler, 167 U. S. 344, 360; Scott v. Armstrong, 146 U. S. 499, 510; Mechanics Bank v. Ernst, 231 U. S. 60; Stone v. Dodge, 56 N. W. 77; Lion Bonding & Surety Co. v. Austin, 208 S. W. 542. It follows that the Guaranty Company, by acquiring, after the Bank became insolvent, the Railway Company's claim against the Bank, did not become entitled to use that claim as a set off against the demand of the Bank based on the bond payable to it. The above mentioned ruling was not erroneous. The judgment is affirmed.

[fol. 46] In United States Circuit Court of Appeals

[Title omitted]

Judgment—Filed January 5, 1924

This cause came on to be heard on the transcript of the record from the District Court of the United States for the Northern District of Texas, and was argued by counsel;

On consideration whereof, It is now here ordered and adjudged by this Court, that the judgment of the said District Court in this cause, be and the same is hereby, affirmed;

It is further ordered and adjudged that the plaintiff in error, United States Fidelity & Guaranty Company, and the surety on the writ of error bond herein, Standard Accident Insurance Company, be condemned, in solido, to pay the costs of this cause in this Court, for which execution may be issued out of the said District Court.

[fol. 47] In United States Circuit Court of Appeals

[Title omitted]

Petition for and Order Allowing Writ of Error—Filed March 6th, 1924

Your Petitioner, United States Fidelity & Guaranty Company, Plaintiff in Error in the above entitled cause, respectfully shows that the above entitled cause is now pending in the United States Circuit Court of Appeals for the Fifth Circuit, and that a judgment was rendered therein on January 5, 1924, affirming a judgment of the District Court of the United States for the Northern District of Texas at Dallas, and that a Motion for Rehearing was duly filed in said Circuit Court of Appeals and was by said Circuit Court of Appeals for the Fifth Circuit denied on February 20, 1924. That the matter in controversy in said suit exceeds One Thousand ($1,000) Dollars besides costs, and that the jurisdiction of none of the courts above mentioned is or was dependent upon the opposite party to the suit or controversy, being aliens and citizens of the United States or citizens of different states, and that this cause does not arise under the patent laws nor criminal laws and that it is not an admiralty case and is not a case wherein the Circuit Court of Appeals has final jurisdiction, but is a suit brought by a national bank receiver duly appointed by the Comptroller of [fol. 48] the Currency of the United States and involves the enforcement of the National Banking Act and is one arising under the laws of the United States, and that it is a proper case to be reviewed by the Supreme Court of the United States upon a Writ of Error.

Your Petitioner would further show that during the pendency of this appeal it desires to supersede the judgment rendered against it and would further show that in the trial court a judgment was rendered against it for Twenty Five Thousand ($25,000) Dollars and that it gave a supersedeas bond in its appeal to the Circuit Court of Appeals in the sum of Thirty Thousand ($30,000) Dollars which was duly approved.

Wherefore, your Petitioner would respectfully pray that a Writ of Error be allowed it in the above entitled cause, directing the Clerk of the United States Circuit Court of Appeals for the Fifth Circuit to send the record and proceedings in said cause, with all things concerning the same, to the Supreme Court of the United States in order that the errors complained of in the Assignments of Error therewith filed by said Plaintiff in Error be reviewed, and if error be found, corrected according to the laws and customs of the United States.

It further prays that during the pendency of this appeal that said judgment be superseded upon this Plaintiff in Error giving bond in such sum, if any, as may be directed by the court.

(Signed) Walter F. Seay, Attorney for Plaintiff in Error.

The foregoing Petition is granted and Writ of Error allowed as prayed for upon Plaintiff in Error giving bond according to law [fol. 49] in the sum of Thirty-five Thousand ($35,000.00) Dollars, which will operate as a supersedeas, this 6th day of March, A. D. 1924.

(Signed) R. W. Walker, United States Circuit Judge.

[fol. 50] In United States Circuit Court of Appeals

[Title omitted]

Assignments of Error—Filed March 6th, 1924

Now comes the Plaintiff in Error, United States Fidelity & Guaranty Company, by Walter F. Seay, its Attorney, and says that in the record and proceedings aforesaid of the United States Circuit Court of Appeals for the Fifth Circuit in the above entitled cause and in the rendering of a final judgment therein, manifest error hath intervened to the prejudice of the Plaintiff in this, to-wit:

1. Said Circuit Court of Appeals erred in rendering judgment and affirming the judgment of the District Court of the United States for the Northern District of Texas for Twenty Five Thousand ($25,000) Dollars and costs of suit in favor of the Defendant in Error and against the Plaintiff in Error.

2. The said Circuit Court of Appeals erred in not reversing said judgment or in not reversing and rendering said judgment afore-

said of said District Court of the United States for the Northern District of Texas for said sum of Twenty Five Thousand ($25,000) Dollars, and in refusing to allow Plaintiff's in Error set-off in the sum of Twenty Three Thousand Three Hundred and Twelve & [fol. 51] 51/100 ($23,312.51) Dollars, in that the undisputed facts show that on the 24th day of August, 1921, the United States Fidelity & Guaranty Company became surety upon the bond of the National Bank of Cleburne, which said bond or agreement of indemnity was payable to the Gulf, Colorado & Santa Fe Railway Company in the penal sum of Fifty Thousand ($50,000) Dollars; the condition of which was to the effect that the Bank would pay to the Railway Company on demand all sums of money then or thereafter deposited by said Railway Company with said bank. This bond ran for one year from the 24th day of August, 1921. That a few days thereafter, to-wit, on the 28th day of August, 1921, the United States Fidelity & Guaranty Company issued its banker's bond for the sum of Twenty Five Thousand ($25,000) Dollars to the said National Bank of Cleburne, insuring it against the dishonest act of any of the employees of said bank wherever committed. This bond ran for a period of one year from August 28, 1921. The further admitted facts show that on and after the 28th day of August, 1921, and until October 17, 1921, one S. B. Norwood was President of the National Bank of Cleburne, and was President until the 17th day of October, 1921, when said Bank failed as the direct and proximate result of the acts and conduct of said Norwood and the taking by him of enormous sums of money and other valuable property of the Bank in a sum exceeding Twenty Five Thousand ($25,000) Dollars, and that as a result of said conduct of said Norwood the Bank was compelled to close its doors and went into the hands of a receiver, the Defendant in Error herein; that by virtue of said acts of said Norwood said Bank was unable to pay, and will never be able to pay, less than ten (10%) per cent nor more than twenty-five (25%) per cent of its obligations to its depositors.

[fol. 52] 3. That at the time of the failure of the Bank and passing into the hands of the Receiver, on October 17, 1921, the said Gulf, Colorado & Santa Fe Railway Company had on deposit in said Bank the sum of Twenty Three Thousand Three Hundred and Twelve & 51/100 ($23,312.51) Dollars, which said Bank at said time was unable to pay and did not pay; that as a result of the United States Fidelity & Guaranty Company having executed a bond for said Bank as its surety, it was requested and required by said Railway Company to pay, and by virtue of said bond and being surety of said Bank, did pay on the 16th day of January, 1922, to said Railway Company the sum of Twenty Three Thousand Three Hundred and Twelve & 51/100 ($23,312.51) Dollars, and on the 24th day of January, 1922, said Railway Company did assign to the United States Fidelity & Guaranty Company all its right, title and interest to all claims, rights or demands against the Bank. On February 1, 1922, such assignment was filed with and

approved by A. P. Wooldridge, Receiver of said Bank, being admitted to be correct in amount, and that the judgment of the court in refusing to reverse and render said cause or to reverse the same and not allowing the set-off of the Plaintiff in Error, is contrary to the law and the admitted facts, in that this Plaintiff in Error is solvent and the Defendant in Error Bank is insolvent and that the potential, incidental or contingent liability on Plaintiff's in Error part to pay to the Defendant in Error on the banker's bond, and the bank's reciprocal, potential, incidental or contingent liability to the Plaintiff in Error herein by virtue of its execution of the bond to one of said Bank's depositors, to-wit, the Railway Company, came into existence several months prior to the insolvency of said Bank, and further the liability of one to the other arose out of the same transaction, to-wit, the infidelity of said Presi- [fol. 53] dent Norwood, and that the actual liability against both the Bank and the Company in their respective favors arose simultaneously when the Bank closed; that the United States Fidelity & Guaranty Company was at that time and in that manner and amount indicated, subrogated to all the rights of the depositor, Gulf, Colorado & Santa Fe Railway Company, and thus standing in the depositor's shoes was entitled to set-off the Bank's claim against it by the amount paid to the Bank's depositor, and in refusing to allow the set-off said judgment, as above indicated, is contrary to law and the agreed facts in the case.

4. The Honorable Circuit Court of Appeals erred in holding that to sustain said set-off would enable the Plaintiff in Error to satisfy debts aggregating more than $48,000.00 by paying only the amount of one of the debts, to-wit, Twenty Five Thousand ($25,000) Dollars, in that while it is true that this Plaintiff in Error is liable to the Bank for Twenty Five Thousand ($25,000) Dollars and to the Railway Company for Twenty Three Thousand Three Hundred and Twelve & 51/100 ($23,312.51) Dollars, the penalty of such liability carried with it such benefits as might inure to it by virtue of it paying, or being required to pay, either of said items.

5. The Honorable Court of Appeals erred in holding that upon the Bank's insolvency being established the Railway Company's claim, so far as the Bank's assets are concerned, gave it no more than the right to file its claim seasonably and share ratably in the disposition of those assets, in that it fails to further hold that in the event the Railway Company had owed the Bank, the Railway Company would have the additional right under such circumstances to set-off any claim the Bank might have had against it by its [fol. 54] claim against the Bank.

6. The Honorable Circuit Court of Appeals further erred in holding that the forbidden result of a preferential payment out of the insolvent Bank's assets of an unpreferred debt owing by it would have to be brought about by the allowing of this off-set, in that any liens, equities or rights arising by express agreement

or implied from the nature of the dealings between the parties or by the operation of law prior to insolvency and not in contemplation thereof, are not invalidated, and where a set-off is valid it cannot be disallowed on the ground that it is a preference, in that it is only the balance, if any, after the set-off is deducted which can justly be held to form a part of the estate of the insolvent.

7. The Honorable Circuit of Appeals further erred in holding that the Plaintiff in Error by acquiring, after the Bank became insolvent, the Railway Company's claim against the Bank, would not entitle it to use the claim as a set-off against the demand of the Bank on the debt due it by virtue of the bond signed by the Plaintiff in Error, in that the right of the surety to subrogation begins with the contract of suretyship and relates back to that time and is not simply inchoate until it pays the debt, and the courts of equity frequently deviate from the strict rule of mutuality when the justice of the particular case requires it, and where the mutual obligations have grown out of the same transaction the insolvency on the one hand justifies the set-off of the debt due upon the other.

Wherefore, the said United States Fidelity & Guaranty Company, Plaintiff in Error, prays that for the errors aforesaid, and other errors appearing in the record of said United States Circuit Court of Appeals in the above entitled cause to the prejudice of Plaintiff in Error, that the said judgment of the United States [fol. 55] Circuit Court of Appeals be reversed and annulled and for naught esteemed, or that said cause be remanded to the District Court of the United States for the Northern District of Texas for new trial in said cause or for such further proceedings in said cause as may be determined by this Honorable Court to the end that justice may be done in the premises.

(Signed) Walter F. Seay, Attorney for Plaintiff in Error.

[fols.56 & 57] Bond on Writ of Error for $35,000—Approved and filed March 17, 1924; omitted in printing

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[fol. 58] In United States Circuit Court of Appeals.

[Title omitted]

Præcipe for Transcript of Record—Filed March 6th, 1924

To the Clerk:

You are requested to make a Transcript of Record to be filed in the United States Supreme Court pursuant to a Writ of Error allowed in the above entitled cause, and to include in such Transcript of Record the following, and no other papers or exhibits, to-wit:

1. Plaintiff's Original Petition.

2. Demurrer and Answer.

Exhibit "A"—Bond of National Bank of Cleburne, August 24, 1921.
"B"—Bankers' Blanket Bond, August 28, 1921.
"C"—Proof of Claim, January 16, 1922.

3. First Supplemental Petition.

4. Agreement of Counsel waiving Trial by Jury.

5. Agreement of Counsel as to Correctness of Facts set out in Petition and answer.

6. Judgment of the Trial Court.

7. Judgment and Opinion of Circuit Court of Appeals.

7a. Assignment of Error filed in Circuit Court of Appeals on Appeal from Trial Court.

8. Bond on Writ of Error from District Court to Circuit Court of Appeals.

9. Petition for Writ of Error to Supreme Court of the United [fol. 59] States and Assignments of Error filed therewith.

10. Writ of Error to Supreme Court.

11. Supersedeas Bond on Writ of Error to Supreme Court (if required).

12. Clerk's Certificate.

Respectfully, (Signed) Walter F. Seay, Attorney for Plaintiff in Error.

We, Counsel for the Defendant in Error, hereby acknowledge receipt and accept service of the above præcipe, designating the parts of the record to be included in the Transcript.

Witness our hands this 12th day of March.
(Signed) Ellis Douthit, Thompson, Barwise & Wharton, Counsel for Defendant in Error.

[fol. 60] In United States Circuit Court of Appeals

Clerk's Certificate

I, Frank H. Mortimer, Clerk of the United States Circuit Court of Appeals for the Fifth Circuit, do hereby certify that the foregoing 59 pages contain full, true and complete copies of the plead-

ings, proceedings and record entries, as specified in the præcipe of counsel, copied at page 58 of the transcript, including the opinion of said United States Circuit Court of Appeals for the Fifth Circuit, in the cause wherein the United States Fidelity & Guaranty Company was plaintiff in error and A. P. Wooldridge, Receiver of National Bank of Cleburne was defendant in error, numbered 4098, as the same remain on file and of record in my office.

I do further certify that the original citation, with acknowledgment of service thereon, and the original writ of error, with my return thereto, are hereby attached, and herewith returned.

In testimony whereof, I hereunto subscribe my name and affix the seal of the said Circuit Court of Appeals, at my office in the City of New Orleans, Louisiana, in the Fifth Circuit, this 20th day of March, A. D. 1924.

Frank H. Mortimer, Clerk of the United States Circuit Court of Appeals, Fifth Circuit. (Seal of the United States Circuit Court of Appeals, Fifth Circuit.)

[fol. 61] In United States Circuit Court of Appeals

[Title omitted]

Writ of Error—Filed March 17, 1924

United States of America: ss:

The President of the United States to the Honorable the Judges of the United States Circuit Court of Appeals for the Fifth Circuit, Greeting:

Because in the record and proceedings, as also in the rendition of the judgment of a plea which is in the said Circuit Court of Appeals, before you, or some of you, between A. P. Wooldridge, Receiver of the National Bank of Cleburne, Plaintiff, and United States Fidelity & Guaranty Company, Defendant, a manifest error hath happened, to the great damage of said Defendant, United States Fidelity & Guaranty Company, as by its complaint appears. We being willing that error, if any hath been, should be duly corrected, and full and speedy justice done to the parties aforesaid in this behalf, do command you, if judgment be therein given, that then under your seal, distinctly and openly, you send the record and proceedings aforesaid, with all things concerning the same, to the Supreme Court of the United States, together with this writ, so that you have the same at Washington within thirty days from the date hereof, in the said Supreme Court, to be then and there held, that [fol. 62] the record and proceedings aforesaid being inspected, the said supreme Court may cause further to be done therein to correct that error, what of right, and according to the laws and customs of the United States should be done.

Witness the Honorable William Howard Taft, Chief Justice of the said Supreme Court, the 17th day of March, in the year of our Lord one thousand nine hundred and twenty four.

Frank H. Mortimer, Clerk U. S. Circuit Court of Appeals.

Allowed by R. W. Walker, U. S. Circuit Judge.

I hereby certify that a true copy of the within writ has this day been lodged in the Clerk's office for the use of the defendant in error.

Dated 17th day of March, A. D., 1924.

Frank H. Mortimer, Clerk. (Seal of the United States Circuit Court of Appeals, Fifth Circuit.)

[fol. 62½] [File endorsement omitted.]

[fol. 63] Citation—In usual form, showing service on Ellis Douthit; filed March 17, 1924; omitted in printing

Endorsed on cover: File No. 30,244. U. S. Circuit Court of Appeals, Fifth Circuit. Term No. 352. United States Fidelity & Guaranty Company, plaintiff in error, vs. A. P. Wooldridge, receiver of the National Bank of Cleburne. Filed April 4th, 1924. File No. 30,244.

No. 2[illegible]

In the

Supreme Court of the United States

October Term 1924.

UNITED STATES FIDELITY & GUARANTY COMPANY,
Plaintiff in Error,

vs.

A. P. WOOLDRIDGE, RECEIVER OF THE NATIONAL BANK OF CLEBURNE,
Defendant in Error.

In Error to the United States Circuit Court of Appeals for the Fifth Circuit.

SEAY, SEAY, MALONE & LIPSCOMB,
Dallas, Texas,
Counsel for Plaintiff in Error.

ELLIS DOUTHIT,
Of Sweetwater, Texas.
THOMPSON, BARWISE,
WHARTON & HINES,
Of Fort Worth, Texas,
Counsel for Defendant in Error.

[illegible] Law Printing Co.—Dallas

INDEX

AUTHORITIES

No. 352

In the

Supreme Court of the United States

October Term 1924.

UNITED STATES FIDELITY & GUARANTY COMPANY,

Plaintiff in Error,

vs.

A. P. WOOLDRIDGE, RECEIVER OF THE NATIONAL BANK OF CLEBURNE,

Defendant in Error.

In Error to the United States Circuit Court of Appeals for the Fifth Circuit.

STATEMENT OF CASE.

The facts in this case are all agreed to, same being tried upon a stipulation before the trial court without a jury.

On August 24, 1921, the United States Fidelity and Guaranty Company became surety upon the bond of

the National Bank of Cleburne, payable to Gulf, Colorado & Santa Fe Railway Company in the penal sum of $50,000.00, the condition of said bond being:

> "The condition of this obligation is such that if the said principal shall pay on demand to said Railway Company the sums of money now or hereafter deposited by said Railway Company with said principal, or to the credit of said Railway Company with said principal, or which may in any manner or for any reason be now or at any time hereafter due or payable by said principal to said Railway Company, then this obligation shall be void, otherwise, it shall remain in full force and effect."

This bond ran one year from the 24th day of August, 1921.

On August 28, 1921, the Plaintiff in Error, United States Fidelity and Guaranty Company, issued to said National Bank of Cleburne what is commonly called "Bankers Blanket Bond" in the sum of $25,000.00, indemnifying said bank against loss, to an amount not exceeding $25,000.00 of money, currency, bullion, bonds, etc., in which said bank had a pecuniary interest, or for which it was legally liable, sustained by the dishonest act of any of the employees through robbery, burglary, theft, hold-up, etc.

On August 24, 1921, and on August 28, 1921, one S. B. Norwood was President of said National Bank of Cleburne and remained such until the 17th day of October, 1921.

On October 17, 1921, said National Bank of Cleburne failed as a direct and proximate result of the acts and defalcations of said Norwood and the taking by him of enormous sums of money in excess of $25,000.00 amounting to perhaps a million dollars or more. That as a direct result thereof on said date, October 17, 1921, said Bank was compelled to close its doors and went into the hands of a Receiver, the Defendant in Error herein. That by virtue of said acts of the said Norwood said Bank is unable to pay, and perhaps will never pay, more than ten to twenty-five per cent to its depositors. On October 17, 1921, (at the time of the failure of the Bank) the said Gulf, Colorado & Santa Fe Railway Company had on deposit in said Bank the sum of $23,312.51, which said Bank at said time was unable to pay, could not pay and did not pay on demand.

On January 16, 1922, the United States Fidelity and Guaranty Company, by virtue of becoming surety of said Bank, was required to pay, and did pay, said Railway Company said $23,312.51.

On April 14, 1922, this suit was brought by the Receiver (Defendant in Error herein) against the United States Fidelity & Guaranty Company, Plaintiff in Error, to recover the $25,000.00 penal sum on the fidelity bond payable to the Bank by virtue of the defalcation of the Bank's President, Norwood.

For answer the Plaintiff in Error (Defendant below) set up the facts with reference to being surety for the Bank and with reference to its having to pay as surety upon the obligation above mentioned the sum of $23,312.51 payable to said Santa Fe Railway Company. It further plead that it had endeavored to pay, and desired to pay, said Receiver the difference between said $25,000.00 due the Bank under said fidelity bond and the $23,312.51 which, as the Bank's surety, it had paid to the Gulf, Colorado & Santa Fe Railway Company—one of the depositors. It asked that said $23,312.51 offset the $25,000.00 and that judgment be entered against it for $1,687.49 in settlement of the Company's liability to said Receiver.

The Receiver plead that as to its obligation as surety for the Bank inuring to the benefit of the Railway Company and on the bond given said Bank indemnifying it against loss by defalcation of any of its officers, that Plaintiff in Error was its paid surety,

having accepted compensation for the execution of both instruments, and that the Plaintiff in Error (Defendant below) was engaged in business of such service, including the character of obligation herein mentioned and alleged. That said bond of indemnity to the Bank was an asset of the Bank and a trust fund for the purpose primarily of paying, so far as it would, the liability of the Bank to various creditors in exact proportion to their respective claims; that it would be unjust and inequitable to allow said funds to be diverted to the claim of any one creditor resultin a preference to such creditor. He further plead that in addition to its liability to the Railway Company as a creditor, it was also liable to numerous other creditors and depositors to the extent of over two million dollars. He plead that said Bank could never be able to pay exceeding 25 cents on the dollar of the amounts owing such creditors of said Bank, and it would be unjust and inequitable to permit or allow the Defendant to offset the Bank's claim against it by virtue of the claim of the Railway Company against the Bank. He plead further that if the surety company was entitled to any subrogation at all that such right should be confined to sharing pro rata in the assets of said Bank with all other creditors and that it should not be permitted to pay off and dis-

charge the liabilities of over $48,000.00 represented by the two instruments signed by it by a total payment of $25,000.00, asserting that to do so would be escaping the obligation of its own contract.

The trial court rendered judgment in favor of the Receiver for $25,000.00 and refused to allow the offset.

The Circuit Court of Appeals affirmed the judgment of the trial court.

The sole question to be determined is whether or not the offset should be allowed.

ASSIGNMENT OF ERROR.

The court erred in rendering judgment for the Plaintiff and in refusing to allow the set-off plead by the Defendant in that the undisputed facts show that on the 24th day of August, 1921, the United States Fidelity & Guaranty Company (Defendant) became surety upon the bond of the National Bank of Cleburne, which said bond or agreement of indemnity was payable to the Gulf, Colorado & Santa Fe Railway Company in the penal sum of Fifty Thousand ($50,000.00) Dollars, the condition of which was to the effect that the bank would pay to the Railway Com-

pany on demand all sums of money then or thereafter deposited by said Railway Company with said bank. This bond ran for one year from the 24th day of August, 1921. That a few days thereafter to-wit, on the 28th day of August, 1921, the United States Fidelity & Guaranty Company issued its banker's bond for the sum of Twenty-Five Thousand ($25,000.00) Dollars to the said National Bank of Cleburne, insuring it against the dishonest act of any of the employees of said bank wherever committed. This bond ran for a period of one year from August 28, 1921.

It is further an admitted fact that on and after the 28th day of August, 1921, and until October 17, 1921, one S. B. Norwood was President of the National Bank of Cleburne, and was President until the 17th day of October, 1921, when said bank failed as the direct and proximate result of the acts and conduct of said Norwood and the taking by him of enormous sums of money and other valuable property of the bank in a sum exceeding Twenty-Five Thousand ($25,000.00) Dollars, and that as a result of said conduct of said Norwood the bank was compelled to close its doors and went into the hands of a Reciever, the Plaintiff herein. That by virtue of said acts of said Norwood said bank is unable to pay, and will never

be able to pay, not less than ten per cent more than twenty-five per cent of its obligations to its depositors.

That at the time of the failure of the bank and the passing into the hands of the Receiver on October 17, 1921, the said Gulf, Colorado & Santa Fe Railway Company, had on deposit in said bank the sum of Twenty-Three Thousand, Three Hundred Twelve and 51/100 Dollars ($23,312.51), which said bank at said time was unable to pay and did not pay; that as a result of the United States Fidelity & Guaranty Company (Defendant) having executed the bond for said bank as its surety it was requested and required by said Railway Company to pay, and by virtue of said bond and being surety of said bank did pay, on the 16th day of January, 1922, to said Railway Company the sum of Twenty-Three Thousand, Three Hundred Twelve and 51/100 ($23,312.51) Dollars; and on the 24th day of January, 1922, the said Railway Company did assign to the United States Fidelity & Guaranty Company (Defendant) all its right, title and interest to all claims, rights or demands against said bank. On February 1, 1922, such assignment was filed with and approved by the Plaintiff, A. P. Wooldridge, Receiver of said bank, being admitted to be correct in amount.

That said judgment of the court in refusing to allow the set-off of this Defendant, is, as above shown, contrary to the law and the admitted facts, in that this Defendant is solvent, and the Plaintiff is insolvent, and that the potential, incidental or contingent liability on Defendant's part to pay to the Plaintiff on the banker's bond, and the bank's reciprocal, potential, incidental or contingent liability to the Defendant herein by virtue of its execution of the bond to one of its depositors, to-wit, Gulf, Colorado & Santa Fe Railway Company, came into existence several months prior to the insolvency of said bank, and further that the liability of one to the other arose out of the same transaction, to-wit, the infidelity of said President Norwood, and that actual liability against both the bank and the Company in their respective favors arose simultaneously when the bank closed. The United States Fidelity & Guaranty Company (Defendant) was thus at the time and in the manner and amount indicated, subrogated to all the rights that the depositor, Gulf, Colorado & Santa Fe Railway Company, had, and thus standing in said depositor's shoes this Defendant was entitled to off-set the bank's claim against it by the amount paid to the bank's depositor, and in refusing to allow said off-set, said judgment,

as above indicated, is contrary to law and the agreed facts in the case (Record 40).

ARGUMENT.

The FIRST proposition contended for is that upon a failure of a bank a depositor in such bank may off-set any claim said bank may have against said depositor to the extent of such deposit.

SECOND. The Receiver takes the assets of an insolvent bank as a mere trustee and creditor, subject to all claims and defenses that might have been interposed as against the insolvent corporation.

THIRD. A surety on paying the debt of its principal is entitled to be subrogated to the rights of the creditor in all or any of the securities, means or remedies which the creditor has for enforcing payment against the principal.

FOURTH. Such right of a surety to subrogation begins with the contract of suretyship and is not simply inchoate until it pays the debt.

FIFTH. Courts of equity frequently deviate from the strict rule of mutuality when the justice of the particular case requires it, and the ordinary rule is

that where the mutual obligations have grown out of the same transaction, insolvency on the one hand justifies the set-off of the debt due upon the other.

SIXTH. A set-off otherwise lid cannot be considered a preference as it is only the balance, if any, after the set-off is deducted which can justly be held to form part of the assets of the insolvent.

SEVENTH. The above rules law and equity as to the rights of a surety to subrogation and set-off are not altered merely because the surety was a compensated one.

The first and second contentio we assume, will not be seriously controverted, and we will content ourselves with the citation of the following cases:

Scott vs. Armstrong (F. & M. Bank vs. Armstrong) 146 U. S. 499; 36 L. Ed. 1059, by Chief Justice Fuller, in our opinion, upholds the same in the following language:

> "The Receiver took the assets of the Fidelity Bank as a mere trustee for creditors and not for value and without notice, and, in the absence of a statute to the contrary, subject to all claims and defenses that might be interposed as against the insolvent corporation before the liens of the

United States and of the general creditors attached."

The **third** proposition to the effect that a surety on paying the debt of its principal is entitled to be subrogated to the rights of the creditors in all or any of its securities, means or remedies which the creditor has for enforcing payment against the principal, and the **fourth** proposition to the effect that the right of a surety to subrogation begins with the contract of suretyship and relates back to that time and is not simply inchoate until it pays the debt—in regard thereto we desire to submit the following:

Prairie State National Bank vs. United States, (United States vs. Charles A. Hitchcock), 164 U. S. 227 (41 L. Ed., p. 412) opinion by Justice White. The facts are as follows:

On May 10, 1888, Charles Sunberg & Company, as principal and Charles A. Hitchcock as surety thereon, entered into a contract with the Government to erect a custom house at Galveston, Texas, for the consideration of $18,590.00. In the contract it was agreed that ninety per cent of the value of the work executed would be paid from time to time as the work progressed in monthly installments, the remaining

one-tenth to be reserved until the work was completed. On February 3, 1890, in consideration of advances made and to be made by the Prairie Bank, Sunberg & Company gave to one Van Zandt, representative of the bank, an order or power of attorney authorizing him to receive the final payment from the Government under the contract. The Secretary of the Treasurer declined to recognize this power of attorney but expressed a willingness on the request of the contractors to forward when it became due the check for final payment to the address of Van Zandt. Between February and May, 1890, upon the faith of the lien upon the final payment the bank advanced to Sunberg & Company about $6,000.00.

In May, 1890, Sunberg & Co. defaulted in the performance of their contract and Hitchcock, as surety, without any knowledge of the alleged rights of the bank, assumed completion of the contract with the consent of the contractors and he disbursed therein about $15,000.00 in excess of the current payments from the Government. Both the bank and Hitchcock filed their claim before the Comptroller of the Treasury which was subsequently transferred to the court of claims. The court of claims allowed Hitchcock a judg-

ment to the fund which was appealed by the bank. The court says:

"The question to be determined is, which of the two contestants possesses a superior right to the fund? * * * The Prairie Bank asserts an equitable lien in its favor, which it claims originated in February, 1890, and is therefore paramount to Hitchcock's lien, which it is asserted arose only at the date of his advances. The claim of Hitchcock, on the other hand, is that his equity arose at the time he entered into the contract of suretyship, and therefore his right is prior in date and paramount to that of the bank. * * * That Hitchcock, as surety on the original contract, was entitled to assert the equitable doctrine of subrogation is elementary. That doctrine is derived from the civil law, and its requirements are, as stated in Aetna L. Ins. Co. vs. Middleport, 124 U. S. 534 (31:537) '(1). That the persons seeking its benefits must have paid a debt due to a third party before he can be substituted to that party's rights; and, (2), that in doing this he must not act as a mere volunteer, but on compulsion, to save himself from loss by reason of a superior lien or claim on the part of the person to whom he pays the debt, as in cases of sureties, prior mortgages, etc. The right is never accorded in equity to one who is a mere volunteer in paying a debt of one person to another.' * * * 'The doctrine of subrogation is a pure unmixed equity, having its foundation in the principles of natural justice, and from its very nature never could have

been intended for the relief of those who were in any condition in which they were at liberty to elect whether they would or would not be bound, and, as far as I have been able to learn its history, it never has been so applied. If one with the perfect knowledge of the facts will part with his money, or bind himself by his contract in a sufficient consideration, any rule of law which would restore him his money or absolve him from his contract would subvert the rules of social order. It has been directed in its application exclusively to the relief of those that were already bound who could not but choose to abide the penalty.' * * * In other words, the rights of the parties depend upon whether Hitchcock's subrogation must be considered as arising from and relating back to the date of the original contract, or as taking its origin solely from the date of the advance by him.

"A great deal of confusion has arisen in the case by treating Hitchcock as subrogated merely 'in the rights of Sunberg & Co.,' in the fund, which, in effect, was saying that he was subrogated to no rights whatever. Hitchcock's right of subrogation, when it became capable of enforcement, was a right to resort to the securities and remedies which the creditor, the United States, was capable of asserting against its debtor, Sunberg & Company, had the security not satisfied the obligation of the contractors, and one of such remedies was the right based upon the original contract to appropriate the 10 per cent

retained in its hands. If the United States had been compelled to complete the work, its right to forfeit the 10 per cent and apply the accumulations in reduction, of the damage sustained remained. The right of Hitchcock to subrogation, therefore, would clearly entitle him when, as surety, he fulfilled the obligations of Sunberg & Company to the government, to be substituted to the rights which the United States might have asserted against the fund. It would hardly be claimed that if the sureties had failed to avail themselves of the privilege of completing work, they would not be entitled to a credit of the 10 per cent reserved in reduction of the excess of cost to the government in completing the work beyond the sum actually paid to the contractor, irrespective of the source from which the contractor had obtained the material and labor which went into the building."

The court concludes:

"Depending, therefore, solely upon rights claimed to have been derived in February, 1890, by express contract with Sunberg & Company, it necessarily results that the equity, if any, acquired by the Prairie Bank in the 10 per cent fund then in existence and thereafter to arise was subordinate to the equity which had, in May, 1888, arisen in favor of the surety Hitchcock."

R. M. Henningsen vs. U. S. F. & G. Co., 208 U. S. 403; 53 L. Ed. 547, opinion by Justice Brewer.

In May, 1903, Mr. R. M. Henningsen and Edward Clive contracted with the United States for the construction of certain buildings at Fort Lawton, in the State of Washington, and entered into a bond with the United States Fidelity & Guaranty Company of Baltimore, as surety, in the penal sum of $11,625.00 for the faithful performance of the contract, and to 'promptly make full payments to all persons supplying labor or materials in the prosecution of the work provided for in said contract.' The contractors failed to pay certain just and lawful claims for material and labor and materials, amounting in the aggregate to $15,409.04. After such default the surety company instituted suit in the United States Circuit Court for the District of Washington, in which it made the contractors and all persons to whom they were indebted for labor and materials defendants, confessing its own liability to the full amount of the bond. A decree was entered, adjudging the company liable to such creditors of the contractors in the full sum of the bond, $11,625.00, and awarding payment to such creditors pro rata, and adjudged that upon such payment the liability of the company upon the bond should be discharged.

On March 16, 1904, pending the performance of the

contract, the contractor made a written assignment of all payments which were then due or might become due on account of the contract, to R. R. Spencer, in trust for the National Bank of Commerce of Seattle, to secure payment of a loan made by the bank to the contractors, October 10, 1903, of $3500.00 and also subsequent loans, and, at the same time, gave as further security an order addressed to the United States Quartermaster, requesting him to deliver to said Spencer all checks of the Government on account of said contract. The moneys so loaned were paid directly by the bank to Henningsen, and handled and disbursed by him, without any supervision or control upon the part of the bank or Spencer. This suit was commenced by the guaranty company by a bill in the Circuit Court of the United States for the District of Washington to restrain the appellants from collecting or accepting the balance due on the contract from the United States. It appeared at the time of the commencement of the suit that there was in the hands of the quartermaster, due upon the contract, the sum of $13,066.00, which he was about to pay to Spencer under the assignment and order. On June 17, 1904, an arrangement was made between the parties, by which the sum of $8,024,21 was paid to certain creditors, and the balance, $5,041.79, was applied in con-

ditional payment of the indebtedness of the contractors to the bank, with a stipulation that, if it should be finally determined that the guaranty company was entitled to receive it, then the bank should pay it to the guaranty company. This suit proceeded to a decree in favor of the guaranty company for $5,041.79, which decree was affirmed by the circuit court of appeals.

The case was affirmed by the Supreme Court of the United States, saying:

> "Whatever equity, if any, the bank had to the fund in question, arose solely by reason of the loans it made to Henningsen. Henningsen's surety was, upon elementary principles, entitled to assert the equitable doctrine of subrogation, but it is equally clear the bank was not, for it was a mere volunteer, and under no legal obligation to loan its money."

Hardaway vs. National Surety Co., 211 U. S. 550; 53 L. Ed. 321, opinion by Justice Day.

On September 28, 1899, the contract was entered into between the United States and Willard and Cornwell, as principal, and the National Surety Company, as surety, for the construction of a lock and dam in the Black Warrior River in Alabama. The contract

was kept so far as the United States is concerned and the surety was relieved from obligation in that regard. The contention involves the construction and application of that condition of the bond which requires the contractors to "promptly make full payment to all persons supplying them labor or materials in the prosecution of the work, provided for in said contract."

On February 5, 1901, Willard and Prowell, the original contractors, made an agreement between themselves and one Coyne by which Coyne was to pay the debts of the firm, to make all future purchases in his own name and to receive all profits from the contract. After February 5, 1901, Coyne carried on the work. The Government made all checks payable to Willard and Cornwell as before, in accordance with the terms of the contract. On June 2, 1903, Coyne, having become financially unable to complete the contract, made a contract in writing with Hardaway and Prowell, in which said Coyne at that time agreed to assign and set over to Hardaway and Prowell all his interest in about $8,300.00 retained and held by the Government under the contract for the building of said lock and dam.

On October 24, 1904, the National Surety Company, appellee, filed a bill in the United States Court at

Louisville, averring the insolvency of the contractors, and that there would be a loss for labor and material which it would be compelled to pay as surety on the bond, asking for an injunction and the appointment of a receiver. On November 8, 1904, an order was made, referring the case to a special master, and providing that parties having claims for labor and materials might prove the same, with the right to contest them, and to take the proofs thereof as in equity cases. The order provided that appellee, the surety company, should pay into court, in satisfaction of the claims and costs of action, such a sum as might be required after the Government payments were exhausted. The claim of Hardaway and Prowell for practically $40,000.00 was filed, being 15% of the costs expended on the contract with Coyne. A special master allowed the claim, and the Circuit Court disallowed the same and upon appeal to the Circuit Court of Appeals the decree was affirmed. $8,161.75 was the amount reserved by the Government under the contract. The Supreme Court, affirming the judgment, says:

> "Nor do we think that Hardaway and Prowell can complain of the disposition of the $8,300.00 (exactly $8,161.75) reserved payments under the contract. This sum was paid into court for work done previous to the making of the contract of

June 2, 1903. The Circuit Court of Appeals held that this sum, thus paid into court, should be credited upon the $13,261.76, which the surety company had been directed to pay into court for the satisfaction of labor claims which had been proved and allowed in the case. The right of the surety to be subrogated had attached to the fund, and was superior to any rights which Hardaway and Prowell had as assignees of Coyne."

Fidelity & Deposit Co. of Maryland vs. Duke, 203 Fed. 661 (Circuit Court of Appeals, Ninth Circuit).

In 1911 there was in existence two bonds on which the Fidelity & Deposit Company was surety on. One of the bonds was payable to the State Treasurer of Washington, protecting the state against any loss by virtue of funds deposited in the Kelso State Bank; the other bond was payable to the bank to protect it against the infidelity of its officers, including the Cashier of the bank. The bank went broke and the surety company was required to pay $46,000.00 loss on the deposits. Both bonds were executed before the liquidation of the bank commenced and the one protecting the State Treasurer was paid subsequent to such liquidation, but before J. P. Duke, State Supervisor of Washington, brought the suit for shortage. The surety company, among other things, plead set-

off arising from the payment of the $46,000.00 as surety for the bank to the State Treasurer and relied on its right of subrogation to the Treasurer. The trial court disallowed the set-off apparently upon the grounds that the claim was not a mutual one and that to do so would give the surety company a preference. The Circuit Court of Appeals in reversing the case uses the following language:

> "In the instant action the plaintiff, like a receiver, represents the bank and sues in its right. He stands in the bank's shoes, and subject to all defenses and rights against the bank. Further adverting to familiar principles defendant, as surety, stands in the cashier's shoes, in no worse position, and entitled to like rights and remedies. Unquestionably, had the bank or supervisor sued the cashier upon this cause, he could set off any debt due him from the bank. Likewise can his surety, this defendant. The claims are mutualy and in the same right. So meritorious and far-reaching are these principles to adjust mutual accounts, that not only may a surety set off debts due him from the creditor or obligee but if principal or creditor is insolvent the surety may set off debts due to the principal from the creditor or obligee. A bank may set off a depositor's debt to it against its deposit debt to him, and the great weight of authority is that a depositor may set-off his deposit credit against his debt to an insolvent bank. Doubtless it will be conceded that

> set-off does not depend upon the variety of contract debt or upon the character of parties. Hence a debt upon a contract of suretyship may be set off equally with a debt by contract of deposit, and a surety corporation for hire may assert set-off equally with any other character of surety."

Further:

> "And in any such set-off is no preference, for only the excess is justly owing or assets to whom due, insolvent or not. That defendant did not pay the bank's debt to the treasurer until after liquidation commenced is immaterial for the obligation to pay preceded that time, and, payment made, subrogation relates to the time of obligation assumed."

Cox vs. New England Equitable Ins. Co., 247 Fed. 955 (Eighth Circuit) Judge Smith.

In 1912 the Government let a contract to Moore & Payne with New England Equitable Ins. Co. as surety, for the construction of a building at Bonham, Texas, for $46,145.00. The payments were to be made by the Government, 90 per cent in monthly estimates and 10 per cent retained until final completion. To procure the bond Moore & Payne made application to the insurance company and assigned their interests to

protect the company in the deferred payments. The contract was performed by Moore and Payne but they left unpaid $9,000.00 for material and labor which the company compromised for $8,182.28.

On June 12, 1914, the Government made final payment to Moore and Payne in the amount of $5,345.63. They owed the Citizens Bank of Missouri about $8,000.00. They gave a check to the bank for $1,000.00 and subsequently the bank credited $4,000.00 more upon the indebtedness of Moore and Payne and later Moore and Payne gave their check for this amount. On October 3, 1914, Moore and Payne were adjudged bankrupts and Cox qualified as trustee. He brought suit against the Citizens Bank to recover $5,000.00.

On September 2, 1915, the surety company filed a petition for the enforcement of its lien with the referee, claiming that by its right of subrogation and by reason of its lien and by reason of said assignment it was entitled to said fund of $4,500.00. The case was tried before the referee who disallowed the surety company's claim for lien priority but allowed it the sum of $8,182.28 as a general creditor against the estate. The case was taken to the District Court where the findings of the referee were reversed and the fund collected from the Citizens State Bank of

$4,500.00 was ordered turned over to the surety company. The trustee appealed. The decree was affirmed the Circuit Court of Appeals holding:

> "But we have reached the conclusion that, aside from a specific consideration of any of these questions, except the tracing, existence, and identity of the fund, the surety company is entitled to an equitable lien upon the fund for all sums paid for labor and materials upon the Bonham building."

Wasco County vs. New England Equitable Ins. Co., et al, 172 Pac. 126; L. R. A. 1918-D 732 (Sup. Court of Oregon). The facts are:

On June 14, 1915, Henry Cromer as principal and the insurance company as surety entered into a contract with Wasco County to construct a certain highway. September 10, 1915, Cromer was obliged to quit because the equipment had been attached by creditors. October 7, 1915, a voluntary petition in bankruptcy was filed by Cromer and he was subsequently adjudged a bankrupt. On October 25, 1915, an agreement was entered into between the county and the insurance company terminating the contract with Cromer and releasing the county from its obligation to complete the highway upon payment by it of the out-

standing labor and material claims. The Company paid claims made against Cromer and approved by him totalling $3,907.22.

August 5, 1915, the bank loaned $200.00 to Cromer and at the same time Cromer signed and delivered to the bank an order directing the county to pay to French & Co., bankers, all money due on August estimate for work done on the J. T. Harper road contract. This order was filed w[illegible] the County Clerk August 6, 1915. Cromer borrowed an additional $800.00 from the bank on August 11, 19[illegible]. When Cromer discontinued work, the County had $920.00 which it had reserved out of the monthly estimate made during the progress of the work. The complaint filed by the County in this case was accompanied by a tender of $920.00 to the Clerk of the Court. The insurance company resorted to the doctrine of subrogation to support its claim. The decree of the trial court was reversed and a decree entered awarding $290.00 to the insurance company. The court says:

> "The insurance company resorts to the doctrine of subrogation to support its claim, while the bank contends that countervailing equities preclude the application of the rule of subrogation."

And further says:

"When the insurance company fulfilled its obligations and paid the debts incurred by Cromer for labor and material, it was entitled to call upon a court of equity and be subrogated to the rights which the county could have asserted against the fund, and the right of subrogation dates back to the time when the insurance company entered into the contract of suretyship. If the right of the county to hold and to apply the moneys is superior to the claim of the bank, and if by paying the claims for labor and material the surety is subrogated to the right of the county, as of the date of the contract of suretyship, it necessarily and inevitably follows that the right asserted by the surety is superior to the claim made by the bank."

And further:

"The equity which the surety has in such funds as are retained, under the agreement with the contractor, has its inception at the time when the surety enters into the contract of suretyship, and hence the contractor can neither supplant this equity nor strip it of its priority by borrowing money from some person not obliged to lend, and assigning the funds to secure the loan."

As to the Fifth Proposition—that courts of equity frequently deviate from the strict rule of mutuality

when the justice of the particular case requires it, and the ordinary rule is that where the mutual obligations have grown out of the same transaction, insolvency on the one hand justifies the set-off of the debt due upon the other—in the first instance, we would call the court's attention to the fact that it is agreed that the facts set forth in the pleadings are correct (Record p. 39). It was alleged by the plaintiff and also by the defendant in the following language:

> " * * * as a direct and proximate result of the acts and conduct of said Norwood, and the taking by him of said enormous sums of money and other valuable property of said bank, that said bank, as alleged by the plaintiff herein, was compelled to close and did close its doors and went into the hands of a receiver, as by the plaintiff alleged, and that as a direct result of said acts of said Norwood, it was unable to pay, is now unable to pay, and will never be able to pay its depositors in said bank. That at the time of said conduct and acts of said Norwood, and at the time of the failure of said bank, the Gulf, Colorado and Santa Fe Railway Company did have on hand in said bank as a depositor therein the sum of $23,312.51, and that under and by virtue of said acts of said Norwood and the closing of the said bank and the appointment of the receiver thereof, said National Bank of Cleburne was unable, is now unable and always will be unable to pay its

depositors; that by virtue of having executed said bond for said National Bank of Cleburne as its surety, this defendant was requested to pay, as said surety, and did as said bank's surety, pay to said Gulf, Colorado and Santa Fe Railway Company the said sum of $23,312.51" (Record pp. 9 and 10).

We think that such facts show that the closing of the said bank, the inability of the bank to pay its depositors, the necessity of plaintiff in error paying said railway company and its liability to the bank because of the defalcation of its President, Norwood, in reality all grew out of the same transaction, or act, to-wit: the embezzling of the enormous sums of money by the President from the bank. This is what caused the loss and liability. In this connection we would call the court's attention to the following statutes of Texas:

> "Art. 1325: Whenever any suit shall be brought for the recovery of any debt due by judgment, bond, bill or otherwise, the defendant shall be permitted to plead therein any counter claim which he may have against the plaintiff, subject to such limitations as may be prescribed by law."
>
> "Art. 1329: If the plaintiff's cause of action be a claim for unliquidated or uncertain damages, founded on a tort or breach of covenant, the de-

> fendant shall not be permitted to set off any claim due him by the plaintiff; and if the suit be founded on a certain demand, the defendant shall not be permitted to set off unliquidated or uncertain damages founded on a tort or breach of covenant on the part of the plaintiff."
>
> "Art. 1330: Nothing in the preceding article shall be so construed as to prohibit the defendant from pleading in set-off any counter-claim founded on a cause of action arising out of, or incident to, or connected with, the plaintiff's cause of action."

While it seems to us that under the facts of this case the losses were connected with the same transaction, however, even if they cannot be contended to be connected with the same transaction or if it can be construed that there is no mutuality between the obligations, courts of equity frequently deviate from the strict rule of mutuality when the justice of the particular case requires it, and the ordinary rule is that where the mutual obligations have grown out of the same transaction, insolvency on the one hand justifies the set-off of the debt due upon the other.

Scott vs. Armstrong (Farmers and Merchants State Bank vs. Armstrong), 146 U. S. 499; 36 L. Ed. 1059, by

Chief Justice Fuller. We find the following language:

> "The right to assert set-off at law is of statutory creation, but courts of equity from a very early day were accustomed to grant relief in that regard independently as well as in aid of statutes upon the subject * * *. Courts of equity frequently deviate from the strict rule of mutuality when the justice of the particular case requires it, and the ordinary rule is that where the mutual obligations have grown out of the same transaction, insolvency on the one hand justifies the set-off of the debt due upon the other."

North Chicago Rolling Mill Co. vs. St. Louis Ore and Steel Co., 152 U. S. 594; 38 L. Ed. 565, opinion by Justice Jackson, in which the following language is used:

> "Cross-demands and counter-claims, whether arising out of the same or wholly disconnected transactions, and whether liquidated or unliquidated, may be enforced by way of set-off whenever the circumstances are such as to warrant the interference of equity to prevent wrong and injustice. * * * By the decided weight of authority it is settled that the insolvency of the party against whom the set-off is claimed is a sufficient ground for equitable interference."

Fidelity & Deposit Co. of Maryland vs. Duke, 293 Fed. 661 (Ninth Circuit), a case very similar in fact to the one here. The court uses this language:

> "A bank may set-off a depositor's debt to it against its deposit debt to him, and the great weight of authority is that a depositor may set-off his deposit credit against his debt to an insolvent bank. (Citing many authorities). Doubtless it will be conceded that set-off does not depend upon the variety of contract debt or upon the character of parties. Hence a debt upon a contract of suretyship may be set-off equally with a debt by contract of deposit, and a surety corporation for hire may assert set-off equally with any other character of surety."

National Bank of the Commonwealth vs. Mechanics' National Bank, 94 U. S. 437; 24 L. Ed. 177, lays down the rule:

> "Claims against such suspended banks, proved to the satisfaction of the comptroller, are of the same efficacy as judgments, and occupy the same legal ground as to interest."

The Sixth Proposition to the effect that a set-off otherwise valid cannot be considered a preference as it is only the balance, if any, after the set-off is deducted which can justly be held to form part of the assets of the insolvent, we think is maintained upon

two separate rules of law approved by this Honorable Court. The first is that the right of subrogation relates back to the time of the contract of suretyship and not merely from the time that the debt is paid by the surety or actual liability upon the surety is invoked. This being correct, then this plaintiff's in error right to the set-off herein contended for began in August, 1921, preceding the failure of the bank in October, 1921, and of necessity could not be a preference. It is upheld, we think, upon the further ground, as stated in the proposition.

We desire to quote from:

Scott vs. Armstrong (Farmers & Merchants State Bank vs. Armstrong), 146 U. S. 499; 36 L. Ed. 1059, by Justice Fuller. In this case it had been urged that to allow set-offs would make a preference. Justice Fuller says:

> "We do not regard this position as tenable. Undoubtedly any disposition by a national bank, being insolvent or in contemplation of insolvency, of its choses in action, securities, or other assets, made to prevent their application to the payment of its circulating notes, or to prefer one creditor to another, is forbidden, but liens, equities, or rights arising by express agreement, or implied from the nature of the dealings between the parties, or by operation of law, prior to insolvency and

not in contemplation thereof, are not invalidated. The provisions of the Act are not directed against all liens, securities, pledges, or equities, whereby one creditor may obtain a greater payment than another, but against those given or arising after or in contemplation of insolvency. Where a set-off is otherwise valid, it is not perceived how its allowance can be considered a preference, and it is clear that it is only the balance, if any, after the set-off is deducted which can justly be held to form part of the assets of the insolvent. The requirement as to ratable dividends, is to make them from what belongs to the bank, and that which at the time of the insolvency belongs of right to the debtor does not belong to the bank."

Chief Justice Fuller further says:

"We are dealing in this case with an equitable set-off, but if on June 20th the note had matured and each party had a cause of action capable of enforcement by suit at once, upon the argument for the receiver the legal set-off would be destroyed just as effectually as it is contended the equitable set-off is. We cannot believe Congress intended such a result, or to destroy by implication any right vested at the time of the suspension of a national bank."

Fidelity & Deposit Co. vs. Duke, 293 Fed. 661 (Ninth Circuit), opinion by Judge Bourquin—a very similar state of facts:

> "And in any such set-off is no preference, but only the excess is justly owing or assets to whom due, insolvent or not. (Citing Scott vs. Armstrong, 146 U. S. 510, and other cases). The defendant did not pay the bank's debt to the treasurer until after liquidation commenced is immaterial, for the obligation to pay preceded that time, and, payment made, subrogation relates to the time of obligation assumed." (Citing the Henningsen case).

The Seventh Proposition is to the effect that the above rules of law and equity as to the rights of a surety to subrogation and set-off are not altered merely because the surety was a compensated one, and in support of that contention we desire to quote from:

Fidelity & Deposit Co. vs. Duke, 293 Fed. 661—we find the following language:

> "Hence, a debt upon a contract of suretyship may be set-off equally with a debt by contract of deposit, and a surety corporation for hire may assert set-off equally with any other character of surety."

The Supreme Court of Texas holds with the rule announced by the Federal Court in this regard:

Lonergan vs. San Antonio Loan & Trust Co., 104 S. W. 1061 (Sup. Crt. of Texas). In this case the court says:

> "How it could be that receiving compensation by the surety would affect the relation between the surety on the bond and the owner of the building has not been suggested by counsel and is not apparent to us. * * * The proposition antagonizes the fundamental requirement that to make a valid contract the minds of the contracting parties must meet and agree upon its terms. We are of the opinion that the holding of the Court of Civil Appeals upon this question was error."

Hess & Skinner vs. Turney, 216 S. W. 621 (Sup. Crt. of Tex.). In this case the court says:

> "We do not agree with the intimation in the opinion of the Court of Civil Appeals that the rules which determine the rights of uncompensated sureties have no application in determining the rights of corporation sureties, who enter into contracts of suretyship for profit. One who contracts as surety for another cannot be held bound save in so far as the law binds a surety. The views of this court on that subject are too clearly and emphatically stated in Lonergan vs. San Antonio Trust Company (cited above) to require further statement."

In conclusion we will undertake to apply the principles of law announced by this court to the facts herein:

That the Receiver (Defendant in Error) took the assets of this insolvent bank as a mere trustee and creditor, subject to all claims and defenses that might have been interposed as against the insolvent corporation. On August 24, 1921, when this Plaintiff in Error became surety upon the bond of the bank payable to the Santa Fe Railway Company to protect its deposits, that as of **that date** its right of subrogation sprang into existence. Upon its payment of this debt of the bank to the Railway Company it was subrogated to all the rights of the Railway Company in all or any of the securities, means or remedies which the creditor (the Railway Company in this instance) had for enforcing payment against the principal, to-wit, the bank. That such right of subrogation began with the contract of suretyship on August 24, 1921; and regardless of the fact that payment was made after liquidation or insolvency of the bank began its right of subrogation related back to the time of the contract of suretyship, to-wit, August 24, 1921. Having paid the bank's debt to the Railway Company of $23,312.51 it was entitled to off-set that debt against

the bank for any debt that the bank might claim due it by this Plaintiff in Error by virtue of the defalcation of Norwood on October 17, 1921. Regardless of the legal right which we think exists in this case to set-off courts of equity frequently deviate from the strict rule of mutuality when the justice of the particular case requires it and insolvency on the one hand justifies the set-off of the debt due upon the other. The allowance of the set-off in this case could not under any circumstances be considered a preference for the reason that in the first place the right to the set-off arose August 24, 1921, the date of the surety contract, which was at a time when the bank was not in an insolvent or failing condition and practically two months preceding liability created under the fidelity bond by virtue of the embezzlement of Norwood on October 17, 1921, and the closing of the bank. In the second place a set-off otherwise valid cannot be considered a preference, in that it is only the balance, if any, after the set-off is deducted which can justly be held to form part of the assets of the insolvent.

The above rules of law and equity as applied to the rights of a surety to subrogation and set-off are not

altered, changed or modified merely because the surety was a compensated one.

We respectfully pray that this case be reversed and here rendered for plaintiff in error allowing said offset.

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SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1924.

No. 352.

UNITED STATES FIDELITY & GUARANTY COMPANY, Plaintiff in Error,

vs.

A. P. WOOLDRIDGE, Receiver of the National Bank of Cleburne.

ADDITIONAL AUTHORITIES SUBMITTED BY PLAINTIFF IN ERROR.

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ADDITIONAL AUTHORITIES SUBMITTED BY PLAINTIFF IN ERROR.

Now comes plaintiff in error and respectfully submits the following additional authorities on the proposition that when one becomes surety for the principal a liability arises upon the part of the principal to indemnify and reimburse surety for any payment made, and this right takes effect as of the date of the suretyship contract.

III.

Rights of Surety upon Payment.

From the inception of the suretyship relation there is an implied legal obligation on the part of the principal to indemnify and reimburse his surety. This implied promise of indemnity is as effectual as if embodied in a written indemnity agreement executed by the principal at the date of its application for the bond.

Williams v. United States Fidelity & Guaranty Co., 236 U. S., 557:

> "The written indemnity agreement embodied in the bankrupt's application to the surety company for execution of the bond, so far as its terms are important here, but expressed what otherwise would have been implied from the relationship assumed by the parties."

This promise of indemnity made at the inception of the suretyship constitutes the surety a creditor of the principal from the time of the execution of the bond. Therefore, to regard the claim of the surety against the principal as arising merely through assignment after insolvency of the principal and payment to the obligee is to ignore the debtor-creditor relationship existing *ab initio* between a surety and its principal.

Rice v. Southgate, 16 Gray, 143:

> "Upon well settled principles, it is clear that the contract of a principal with his surety to indemnify him for any payment which the latter may make to

the creditor in consequence of the liability assumed takes effect from the time when the surety becomes responsible for the debt of the principal. It is then that the law raises the implied contract or promise of indemnity. No new contract is made when the money is paid by the surety, but the payment relates back to the time when the contract was entered into by which the liability to pay was incurred. The payment only fixes the amount of damages for which the principal is liable under his original agreement to indemnify the surety. Gibbs *v.* Bryant, 1 Pick., 121; Appleton *v.* Bascom, 3 Met., 169."

Barney v. Grover, 28 Vermont, 393:

"The assignee takes the account subject, of course, to all offsets and equitable defenses. And we think there exists in a surety an equity from the time of his assuming the relation, by virtue of the implied undertaking on the part of the principal, to see him indemnified, and that, although no perfected right of action accrues until actual payment, still such payment has such reference to the original undertaking of suretyship that it overrides any equities of a subsequent date.

"This was so held in a somewhat similar case where the debt was attached by trustee process: Strong *v.* Mitchell & Trustees, 19 Vt., 644, where it was decided that the trustee might offset payments made under precisely the same state of facts as in the present case; such payments being made after the service of the trustee process. The principle of that case is the same with the present.

"And in the case of Beach Qui Tam *v.* Boynton, 26 Vt., 725, it was held that a surety, upon the payment of the debt, was to be regarded as a creditor

from the date of his suretyship. The equity of the defendant in this case is therefore superior to that of the assignee."

Beaver v. Beaver, 23 Pa. St., 167:

"In a suit by administrators of an insolvent estate the defendant is entitled to credit for payment by him of a note, in which he was surety for the decedent, though paid by the defendant since the institution of the suit."

Walker v. Dicks, 80 N. C., 263:

"A surety before he has suffered from his suretyship has the right to use his liabilities, as such, as an equitable counter-claim against a debt he owes his insolvent principal."

M. Kalin v. Bro. V. Bledsoe, 98 Pac., 921 (Okla.):

"It has been repeatedly held by the courts that a surety is a creditor of his bankrupt principal, and that he is such creditor before default and from the date of signing the note. In re Stout (D. C.), 109 Fed., 784; Surngstone *v.* Heineman, 120 Fed., 786; 57 C. C. A., 150; Swartz *v.* Siegel, 117 Fed., 13; 54 C. C. A., 399."

Craighead v. Swartz, 67 Atl., 1003 (Pa.):

"A principal who is insolvent cannot collect a debt which the surety owes him without his indemnifying the surety." 1 Brandt on Suretyship and Guaranty (2 Ed.), par. 227. See also, Abbey *v.* Van Campen, 1 Freem, Ch. (Miss.), 273; Mattingly *v.* Sutton, 19 W. Va., 19; Walker *v.* Dicks, 80 N. C., 263; Mecurn *v.* Austin, 58 Conn., 22; 18 Atl., 1029;

7 L. R. A., 84. "The surety of an insolvent debtor cannot be compelled to pay a debt he owes his principal until he is released of his responsibility of suretyship, and may retain what he owes as a counterclaim against such surety."

Allen v. Van Campen, 1 Freem. Ch. (Miss.), 273:

"A court of equity will not permit a principal at law to enforce against the defendant the collection of a debt, when the defendant stands as surety for the principal to an amount greater than that sued for, unless the principal will fully indemnify the defendant against his liability as his surety, more especially if the principal is shown to be insolvent.

"A surety has, in respect of his liability, the right of a creditor as against his principal and upon the the insolvency of the principal debtor he may retain any funds belonging to such debtor by way of indemnity against his liability."

Labbe v. Bernard, 82 N. E., 688 (Mass.):

"While it is true that the rights of the sureties to the remedies of the principal do not become complete, and are incapable of present enforcement, until they shall have discharged their principal's obligation, yet their right became an inchoate one as soon as they had entered into the relation of suretyship; and their equitable assignment of their principal's rights and remedies, when completed by their performance of his obligation, relates back, as against each other and their principal, to that earlier time."

Dudley Lumber Co. v. Nolan Bros., 156 S. W., 465 (Tenn.):

"There can be no doubt that a surety or indorser, who pays his principal's demand, has status, as such, to enforce an equitable set-off against a demand sued by such principal himself, if that principal be insolvent. There is nothing in any contingent feature incident to the claim of a surety or indorser that defeats the right."

Respectfully submitted,

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No. 352

IN THE

Supreme Court of the United States

October Term 1924

UNITED STATES FIDELITY & GUARANTY COMPANY, Plaintiff in Error.

vs.

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In Error to the United States Circuit Court of Appeals for the Fifth Circuit.

Brief of FIDELITY AND DEPOSIT COMPANY OF MARYLAND Amicus Curiae

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In the

SUPREME COURT OF THE UNITED STATES

October Term, 1924

UNITED STATES FIDELITY & GUARANTY COMPANY,

Plaintiff in Error.

vs.

A. P. WOOLDRIDGE, RECEIVER OF THE NATIONAL BANK OF CLEBURNE,

Defendant in Error.

In Error to the United States Circuit Court of Appeals for the Fifth Circuit.

STATEMENT OF THE CASE.

Fidelity and Deposit Company of Maryland appearing as amicus curiae, is not in any wise interested in the controversy between the parties to this action but it is interested in the principle involved. Accordingly, it refers to and adopts, for the purposes of this brief, the statement of the case and assignment of errors found in the brief of the plaintiff in error.

ARGUMENT

I.

LEGAL SET-OFF

Set-off was unknown at common law and a defendant who had a demand against one who had brought an action against him at law was compelled for relief to resort to a cross-action. Doubtless it was the inconvenience, delay and hardship necessarily incident to

this course, as well as the frequent miscarriage of justice, that early caused relief to be granted in equity. The earliest English statute permitting set-off in an action at law was passed in 1729 although the colony of Virginia had as early as 1645 passed such a statute. Similar laws were adopted in other colonies prior to the enactment of the statute of set-off in England. Such statutes are now in force in practically every American State.

II.

EQUITABLE SET-OFF

Quite independently of statute, and prior to any statute upon that subject, Courts of Equity exercised the power to compel set-off upon general equitable principles. Statutes allowing set-off have not taken away that power but have merely provided a remedy in actions at law whereby claims that should be deemed reciprocally compensated may be set-off against each other—a thing that could always have been done in equity. Such statutes have in many instances made unnecessary any application to equity for relief.

The rule is thus stated in 24 R. C. L. p. 803-4:

> "Although the doctrine of set-off was not recognized at common law, it was so absolutely necessary to the administration of justice that a court of equity could not fail to supply it when the common law omitted it, and long prior to the statute of set-offs it had been a familiar and favorite principle of courts of chancery to adjust in one suit all conflicting demands between the parties, which were readily capable of such adjustment, where, from the relations and situation of the parties and from the nature of their mutual claims, equity and justice seemed to require a complete and speedy settlement. Consequently the jurisdiction of equity is not based upon any statutes of set-off,

> and would exist as well without any such statutes as it now does, and would not be in any sense affected by the repeal of those statutes. But while courts of equity exercise an original jurisdiction over questions of set-off, in the main they follow the same general rules as a court of law, in respect thereto, except where there is some equitable ground, growing out of the transaction or the relation of the parties, which brings the case within the general jurisdiction of a court of equity, and justifies granting the relief beyond the rule of law. By the exercise of this equitable jurisdiction the courts are enabled to do justice between the parties in cases not strictly within the provisions of the statute."

So far as availability of this defense is concerned, it is immaterial that it is equitable as under the Act of March 3, 1915 equitable defenses may now be interposed in actions at law without the necessity of filing a bill on the equity side of the Court.

If the surety company is denied the right to set off the sums it has paid for the bank against sums due from the surety to it, the latter will be without remedy and must pay in full the sums it owes to the bank and lose the sums it has paid out for it. It is in these circumstances that the rule of equitable set-off particularly applies, and regardless of the statute equity will protect the surety to the extent that it will not permit a recovery to be had upon the obligation due to the insolvent or his estate until the surety has been fully indemnified and such set-off will be permitted even where the debt due from plaintiff (the bank) had not matured at the time of the appointment of its assignee or receiver or at the time of the commencement of the action.

Fidelity and Deposit Co, vs Duke, 293 Fed 661;
Nolan Bros. L Co. vs Dudley Lumber Co, 156 S. W. 465 (Tenn.)
Scott vs. Armstrong, 146 U. S. 29, 36 L. Ed. 1059
Northside State Bank vs. United States Fidelity and Deposit Co. 220 Pac 823 (Wash.)
Perry vs. Pye, 102 N. E. 653 (Mass.);
Jump vs. Leon, 192 Mass. 511, 78 N. E. 532, 21 R. C. L. 1113;
Merwin vs. Austin, 18 Atl. 1029 (Conn.)
Craighead vs. Swartz, 67 Atl. 1003 (Pa.);
New Farmers' and Traders Bank vs. Crowe, 82 S. S. W. 286 (Ky.);
Bibb Land and Lumber Co. vs. Lima M. Co. 30 S. W. 677 (Ga);
Brittain vs Quiet, 54 N. C. 328, 62 Am. Dec. 202;
Voorhees vs. Mason, 182 Ill. App 569;
Mercer vs. Dyer 39 Pac 314 (Mont.)
Eigenmann vs. Clark, 21 Ind, App. 129, 51 N. E. 725;
Barbour vs. The Bank 50 Ohio St. 90 (100-1), 33 N. E. 547
Thomas vs. Exchange Bank 68 N. W. 780 (Iowa);
Williams vs. Johnson, 144 Pac 768 (Mont.);
Morse on Banks and Banking Sec. 338
21 R. C. L. 1113.
34 Cyc. 674.
32 Cyc. 246.

In 24 R. C. L. 843, the rule is thus stated:

"But a court of equity has power to permit an equitable set-off in cases not within the statute, if, from the nature of the claim or the situation of the parties, justice cannot be obtained by a cross action. Thus where there are, upon accounts, mutual credits between two parties, though they cannot be set-off at law, yet it is the common ground of a bill in equity and it has been frequently held that set-off

based on insolvency may be allowed in equity notwithstanding the claim of the defendant was not mature at the time of the commencement of the action."

In 21 R. C. L. 1123, it is stated:

> "A sole solvent surety for a hopelessly insolvent principal, on a debt that was due before the appointment of a trustee in insolvency, is entitled to set-off his claim for the payment of such debt against the debt due from him to the insolvent, in a suit on them brought by the trustee, although the insolvency was not known when the debt became due and payment by the surety was not actually made until after the trustee was appointed.
>
> . . . . When the holder of a claim not yet due, arising upon contract, becomes insolvent, and transfers the same before maturity, and the debtor at the time of the transfer holds a similar claim then due, against the assignor, his right of set-off is preserved against the assignee when the latter's cause of action arises; and a surety on the obligation so transferred may enforce the set-off for his own protection if the principal debtor be insolvent."

The rule is stated in 32 Cyc. 246, as follows:

> "If, however, the principal or his estate, is insolvent, equity recognizes the right of the surety to retain any funds of the principal in his hands, even as against an assignee of the principal; and the principal will not be allowed to recover from his surety without first indemnifying the latter."

In Schuler vs. Israel, 120 U. S. 506, 30 L. Ed. 707 the Court said:

"As we understand the law concerning the condition of a garnishee in attachment, he has the same rights in defending himself against that process at the time of its service upon him that he would have had against the debtor in the suit for whose property he is called to account. And while it may be true that in a suit brought by Israel against the Bank it could in an ordinary action at law only make plea of set-off of so much of Israel's debt to the Bank as was then due, it could, by filing a bill in chancery in such case, alleging Israel's insolvency, and that, if it was compelled to pay its own debt to Israel, the debt which Israel owed it, but which was not due, would be lost, be relieved by a proper decree in equity; and, as a garnishee is only compelled to be responsible for that which, both in law and equity, ought to have gone to pay the principal defendant in the main suit, he can set up all the defenses in this proceeding which he would have in either a court of law or a court of equity."

In North Chicago R. M. Co. vs. St Louis O. & S. Co. 152 U. S. 596, the Court cites and quotes from Schuler vs. Israel supra with approval.

In Nashville Trust Co. vs. Fourth Nat. Bank, 18 S. W. 822 (829) (Tenn.) after careful consideration the Court says:

"The question is, assuming the insolvency of the party owing the unmatured debt, can his debtor, when sued by the insolvent on a debt which is due, set-off against it, in equity, the unmatured debt, because of the insolvency? We are of opinion that both reason and weight of authority answer in the affirmative.

In Wilkens & Lange vs. Christian, 223 S. W. 253, (225) (Texas) the Court said:

"The general rule of law is that an undue obligation of the plaintiff in favor of the defendant cannot be interposed as a defense to a present demand of the plaintiff but equity permits such defense when it is shown that the plaintiff is insolvent, since in such case it would be inequitable to permit the plaintiff to recover and leave the defendant with a just claim against the plaintiff without any means for its enforcement."

In St. Paul & M. Trust Co. vs. Leck, 58 N. W. 826, the Supreme Court of Minnesota said:

"From these authorities there can be little or no controversy over the proposition that had the bank itself while insolvent, and prior to an assignment, brought an action upon the note in question, defendant McLeod could have invoked the power of the court in his behalf, and could have been allowed to interpose his equitable set-off arising out of the certificate of deposit, although it had not then matured. . . .

. . . In line with this reasoning, the counsel for respondent in the case at bar argues that, if the defendant McLeod can be allowed to set off the certificate to the amount of his note, he thereby gains the preference over other creditors forbidden by our insolvency law. One answer to this line of argument is that, whenever a debtor is insolvent, all of his creditors are interested in the equality of distribution referred to. The interest in having the estate of an insolvent ratably distributed among all of his creditors arises out of the fact of his insolvency, and not by the assignment. If the general body have superior equities as to the property and its distribution over the equitable rights of one of their number, they must antedate and have become vested before the assignment. It seems to

us that any line of reasoning based upon the proposition that these superior equities are not brought into existence until the assignment is made, and then suddenly come to life, while at the same time, all as if by the wand of the magician, the former and natural equity of the single creditor as suddenly disappears, is unsound. We are convinced that the better rule is that an equitable set-off which the debtor of an insolvent has at the time the latter stops payment is not affected or altered by an assignment. This statement is well supported by authorities, some from jurisdictions governed statutory provisions similar to our own. Schuler v. Israel, 120 U. S. 506, 7 Sup. Ct. 648; Carr v. Hamilton, 129 U. S. 252 9 18 Atl. 1029; Receivers v. Paterson Gas Light 13 Sup. Ct. 148; Merwin v. Austin, 58 Conn. 22, Sup. Ct. 295 Scott v. Armstrong 146 U. S. 499, Co., 23 N. J. Law, 283; Nashville T. Co. v. Bank, 91 Tenn. 336, 18 S. W. 822; Barbour v. Bank (Ohio) 33 N. E. 542.

In the case of Jump vs. Leon, 192 Mass. 511, 78 N. E. 532, the set-off was denied on account of the peculiar statute of the state relating to estates of deceased persons but the course of the opinion the Court cites with approval its earlier decisions to the effect that if before verdict, the estate had been declared to be insolvent, "the set-off claimed could have been enforced although the notes were not due at the date of the plaintiff's writ."

In United States F. & G. Co. vs Ryan, 214 Pac. 433, (437) (Wash.), the plaintiff was surety upon a bond and in considering the question of the maturity of its liability, the Court said:

"Just when such surety becomes such creditor may not be readily determinable under all circumstances, but we think it safe to assert that

such surety becomes a creditor of his bankrupt principal in any event not later than the default of his principal, which fixes the liability upon him as surety. It might be said that up to that time the suretys liability is only potential, but we think his liability cannot in any event be so viewed thereafter. By the principal's default the surety's liability becomes fixed, though it may be unliquidated as to amount."

III.

RIGHTS OF SURETY UPON PAYMENT

Where a surety pays the debt of its principal its right under the subrogation relates back to the date when it entered into the contract of suretyship under which it was required to and did pay its principal's debt.

Fidelity and Deposit Company vs. Duke, 293 Fed. 661;
Prairie State Bank vs. U. S. 164 U. S. 227, 41 L. Ed. 413;
Henningsen vs. U. S. F. & G. Co. 143 Fed. 810; (C. C. A. 9th Circuit) 208 U. S. 404 53 L. Ed 547;
First National Bank vs City Trust, S. D. & S. Co. 114 Fed. 529 (C. C. A. 9th Circuit).
Wasco County vs. New England Equitable Insurance Co. 172 Pac. 126 (Ore.);
In re Scofield Co. 215 Fed. 45 (50) (C. C. A. 2nd Circuit);
In re P. McGarry & Son, 240 Fed. 400 (C. C. A. 7th Circuit);
Derby vs. U. S. F. & G. Co. Pac. 500 (Ore.);
In re Scott, 109 Fed. 794.

The case of Fidelity and Deposit Company vs. Duke, 293 Fed. 661, is exactly in point here not only upon the foregoing proposition but in all other respects. In deciding that case, the Court said:

"In the instant action the plaintiff, like a receiver, represents the bank and sues in its right. He stands in the bank's shoes, and subject to all defenses and rights against the bank. Further adverting to familiar principles, defendant, as surety, stands in the cashier's shoes, in no worse position, and entitled to like rights and remedies. Unquestionably, had the bank or supervisor sued the cashier upon this cause, he could set off any debt due him from the bank. Likewise can his surety, this defendant. The claims are mutual and in the same right. So meritorious and far-reaching are these principles to adjust mutual accounts, that not only may a surety set off debts due him from the creditor or obligee (Curtis v. Davidson, 215 N. Y. 395, 109 N. E. 481; Clark v. Sullivan, 2 N. D. 103, 49 N. W. 416, 13 L. R. A. 233; Wilson v. Bank, 122 Ga. 495, 50 S. E. 357, 69 L. R. A. 97, 2 Ann. Cas. 597), but if principal or creditor is insolvent (and both are here), the surety may set off debts due to the principal from the creditor or obligee. See cases, 32 Cyc. 232.

A Bank may set off a depositor's debt to it against its deposit debt to him, and the great weight of authority is that a depositor may set off his deposit credit against his debt to an insolvent bank. Scott v. Armstrong, 146 U. S. 506, 13 Sup. Ct. 148, 36 L. Ed. 1059; Puget, etc., Bank Co. v. Wash. Pav. Co 94 Wash. 504, 162 Pac. 872; Cases in notes, 25 A. L. R. 938. Doubtless it will be conceded that set-off does not depend upon the variety of contract debt or upon the character of parties. Hence a debt upon a contract of suretyship may be set off equally with a debt by contract or deposit, and a surety corporation for hire may assert set-off equally with any other character of surety. The general statute of Washington, in its provision

for set-off of cross-demands, does not except, and so includes, sureties and debts to them. Rem. Codes 1922, Sec. 266.

And in any such set-off is no preference, for only the excess is justly owing or assets to whom due, insolvent or not. Scott v. Armstrong, 146 U. S. 510, 13 Sup. Ct. 148, 36 L. Ed. 1059; St. Paul etc., Co. v. Leck, 57 Minn. 87, 58 N. W. 826, 47 Am. St. Rep. 576. That defendant did not pay the banks debt to the treasurer until after liquidation commenced is immaterial, for the obligation to pay preceded that time, and payment made, subrogation relates to the time of obligation assumed. Henningsen v. U. S. Fid. Co., 143 Fed. 814, 74 C. C. A. 484.

The bank contracted to reimburse defendant for payment of the former's debt to the treasurer. Payment made, and defendant sued upon its contract to reimburse the bank for the cashier's default, in our opinion defendant is entitled to set off the former debt against the latter."

In M. Kahn & Bro. vs. Bledsoe, 98 Pac. 921 says:

"It has repeatedly been held by the courts that a surety is a creditor of his bankrupt principal, and that he is such creditor before default and from the date of signing the note."

In Griffin vs. Long, 131 S. W. 672, (Ark.) the Court said:

"When one becomes surety for a principal, a liability arises upon the part of the principal to indemnify the surety for any payment he may be compelled to make for the principal. Hill vs. Wright 23 Ark. 530; Rice vs. Darrian 57 Ark. 571, 22 S. W. 213. The principal thus became indebted

to surety for the payments he is compelled to make for the former, and the question which arises is: Does such indebtedness have its inception from the time the party became surety or from the time payment is made by the surety? The true rule seems to be that the surety becomes a creditor of the principal at the time he signs the note as surety, and not at the time he pays the same. In the case of Wiggin vs. Flower, 5 Rob. (La.) 406, it is said: 'Though the obligation of a surety cannot be enforced until after the event on which it becomes absolute, it exists from the time it was contracted, so the rights of the surety against his principal exist before the obligation of the former become absolute.' In the case of Stout (D. C.) 109 Fed. 794, it is said: 'The payment of a note by a surety relates back to the signing of the note for the purpose of fixing the date when the indebtedness of the principal to him on account of such payment had its inception.' In Rice vs. Southgate, 16 Gray (Mass) 142, it was decided that: 'The liability of a principal to indemnify his surety for any payment that the latter may be compelled to make for for the former takes effect from the time when the surety becomes responsible for the debt of his principal, and that upon payment by the surety his debt is a debt contracted at the time he become responsible, and not at the time of such payment.' See also Byers vs. Franklin Coal Co., 106 Mass. 131, Loughridge vs. Bowman 52 Mass. 546; Berry vs. Ewing 91 Mo. 397, 3 S. W. 877."

In re Stout, 109 Fed. 794, the Court holds that where one becomes surety for another, the law raises an implied contract that the principal will indemnify the surety and quotes with approval the following from Berry vs. Ewing, 91 Mo. 397, 3 S. W. 877: "and this implied contract took effect from the date of surety's signing the

note, and not merely from the time he paid the money; the payment in such case relating to the inception of the implied liability."

IV.

To allow set-off is not to give a preference.

Again is the case of Fidelity and Deposit Company vs. Duke exactly in point. As the Court said in that case:

> "And in any such set-off is no preference, for only the excess is justly owing or assets to whom due, insolvent or not. Scott v. Armstrong, 146 U. S. 510, 13 Sup Ct. 148, 36 L. Ed. 1059; St. Paul, etc., Co. v. Leck, 57 Minn. 87, 58 N. W. 826, 47 Am. St. Rep. 576. That defendant did not pay the bank's debt to the treasurer until after liquidation commenced is immaterial, for the obligation to pay preceded this time and, payment made, subrogation relates to the time of obligation assumed. Henningsen v. U. S. Fid. Co., 143 Fed. 814, 74 C. C. A. 484.
>
> The bank contracted to reimburse defendant for payment of the former's debt to the treasurer Payment made, and defendant sued upon its contract to reimburse the bank for the cashier's fault, in our opinion defendant is entitled to set off the former debt against the latter."

In the Court below, it was contended successfully by counsel for the Receiver, that to allow set-off in the circumstances of the present case would be to give the defendant a preference over other creditors contrary to the Federal Statute with respect to the distribution of the assets of insolvent national banks and that therefore this relief should be denied. While these statutes are urged as having some bearing upon the situation it cannot be a mere coincidence that in the cases cited

by the Receiver, they are not made the basis of decision which in every instance is made to rest upon general principles.

While insolvency is ever a favored ground for the interposition of equity, and while it is out of the bank's insolvency that the doctrine here invoked of equitable set-off arises, the appointment of a receiver for an insolvent bank under Federal Statutes with the duty of ratable distribution neither gives the right of set-off where previously it did not exist nor takes away that right where it might otherwise be claimed.

As was said by the Supreme Court in the leading case of Scott vs. Armstrong, 146 U. S. 499, 36 L. Ed. 1059:

> "Where a set-off is otherwise valid it is not perceived how its allowance can be considered a preference, and it is clear that it is only the balance, if any, after the set-off is deducted, which can justly be held to form part of the assets of the insolvent. The requirement as to ratable dividends is to make them from what belongs to the bank, and that which at the time of the insolvency belongs of right to the debtor does not belong to the bank."

The Receiver took the assets and he took the liabilities—the one as much as the other. He took the assets subject to such liens, just claims, rights, and contract obligations as then existed. Among those contract obligations, giving definite rights to the contracting parties, were those growing out of the relations between the bank and the surety company that are involved here. If out of those transactions "a set-off otherwise valid" arose, the Receiver took subject to it.

Aside from the principle that in every contract of suretyship there is on the part of the principal the implied contract that it will indemnify the surety (and

which contract is breached by insolvency and the appointment of a receiver), there is a further principle that in the event the surety is required to pay the debt for which it is surety its rights relate back to the state of the contract of suretyship. This is a right in favor of the surety which existed at the time of the appointment of the receiver. To give effect to that right is not taking anything away from the receiver. Whenever the surety pays its principal's debt, then by the rule of law its rights become fixed as of the date of the inception of suretyship. Thus the surety becomes entitled to reimbursement and to set-off as of the date of its contract of suretyship, and the receiver representing the principal took subject to this right on the part of its surety.

In speaking of just such a claim as is urged by the Receiver here, the Supreme Court of Minnesota in the case of St. Paul & M. Trust Company vs. Leck, supra, said:

> "It seems to us that any line of reasoning based upon the position that these superior equities (of general creditors) are not brought into existence until the assignment is made, and then suddenly come to life, while at the same time, all as if by the wand of the magician, the former and natural equity of a single creditor as suddenly disappears, is unsound."

We think that the lower Court was in error in refusing to allow the set-off claimed and that the case should be remanded with direction to allow it and to enter judgment accordingly.

Respectfully submitted,

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No. 352

In the

Supreme Court of the United States

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UNITED STATES FIDELITY AND GUARANTY COMPANY,
Plaintiff in Error,

vs.

A. P. WOOLDRIDGE, RECEIVER OF THE NATIONAL BANK OF CLEBURNE, *Defendant in Error.*

In Error to the United States Circuit Court of Appeals for the Fifth Circuit

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———o———

In Error to the United States Circuit Court of Appeals for the Fifth Circuit

———o———

STATEMENT OF THE CASE

Reported below 295 Fed. 847.

This was an agreed case as to the facts, and the statement of the case as made by Plaintiff in Error is substantially accurate, but we deem it advisable to point out a few facts not covered by the agreement as outlined by Plaintiff in Error. And will point some additional ones towards close of this brief.

The bond of the Gulf, Colorado & Santa Fe Railway Company, a part of which was quoted in the

statement made by Plaintiff in Error, contained also the following provision (Record, p. 11):

> "The surety may terminate this bond at any time prior to default on giving 15 days' notice in writing to the obligee, after which time all liability hereunder shall cease."

The honesty bond (Record p. 11) recited a consideration paid to the insurance company, plaintiff in error, of $1,250 referred to that company as underwriter for the period of one year from the 28th day of August, 1921, the date of the obligation and agreed to indemnify the insured, The National Bank of Cleburne, and hold it harmless from and against any loss to an amount not exceeding $25,000, through any dishonest act, etc., of its employees. The bond also covered losses by robbery, and other provisions not necessary to mention.

It also provided (Record p. 13) that in the event the insured or the underwriter should recover any loss made under the bond other than insurance or suretyship, the net amount of such recovery, less costs and expenses of making same, should be applied to reimburse the insured in full for loss, and the excess, if any, to be paid to the underwriter, and that the insured should execute all necessary papers to secure the underwriter those rights.

This bond further provided (Record p. 14, subdivision 10) that if the insured should hold as indemnity any valid enforcible security, the underwriter should be liable only for such proportion of the loss as the

amount of the bond bears to the aggregate amount of the bond and other security.

It is also shown (Record p. 2) that on October 17, 1921, and for many years prior thereto, the National Bank of Cleburne, Texas, was a national bank with its place of business in the City of Cleburne, Johnson County, Texas, and that said institution was duly incorporated under the laws of the United States pertaining to the incorporation, operation and control of such banks.

And further (Record p. 2), that on the 17th of October, 1921, and for some days prior thereto, said bank was insolvent.

It is further averred (Record p. 2, subdivision V) that defendant in error, A. P. Wooldridge, was on or about November 1st duly appointed Receiver of said Bank by the Comptroller of Currency of the United States in accord with law governing national banks and pertaining to the appointment of Receivers thereof, and that such Receiver was under the authority of the Comptroller of Currency of the United States, winding up the affairs of said bank.

It is further averred by plaintiff in error (Record p. 9, subdivision 7) that the plaintiff in error was requested to pay and did pay, by reason of its suretyship on the railway bond, the sum of $23,312.51 to said railway on the 16th day of January, 1922, and that thereby it was subrogated to all rights or claims that the railway might have against said bank, but no facts are set up which show that plaintiff in error was

subrogated in any way to any rights other or different than those possessed by the Gulf, Colorado & Santa Fe Railway Company. In a supplemental petition, and in paragraph 4 thereof (Record p. 18) it was averred by defendant in error that the bond executed in behalf of the National Bank of Cleburne to protect against the wrongful acts of its president

> "became and is an asset of the bank and a trust fund for the purpose primarily of paying off and discharging, so far as it will, the liabilities of said bank to its various creditors in exact proportion to their respective claims, and hence it would be unjust and inequitable to allow or permit said fund so established for said purposes to be diverted to the claim of one creditor, resulting in a preference to such creditor in violation of the terms and provisions of the laws of the United States."

Defendant in error further averred (Record p. 18) that at the time the bank closed its doors, and at the time of the receivership, there were a large number of creditors, including Johnson County, Texas, and that said National Bank of Cleburne owed said Johnson County over a million dollars, and owed other depositors and creditors various and sundry amounts, making a total aggregate of over two million dollars, and that after realizing on all of the assets of the bank, it would be unable to pay its creditors exceeding 25 cents on the dollar, and that it would be unjust and inequitable to allow the plaintiff in error to offset the claim of the Railway Company and pay such claim in full, to the detriment of the interests of all other credi-

tors, but if plaintiff in error was entitled to any subrogation, same should be confined to its prorata in the assets of said bank with other creditors, the same as the Railway would have had to share, and plaintiff in error should not be permitted to occupy a higher position than that occupied by the Railway Company nor permitted to "pay off and discharge its liabilities of over $48,000, as represented by the two bonds by a total payment of only $25,000, thereby escaping the obligation of its own contracts, which it had undertaken for a valuable consideration."

It was stipulated (Record p. 19) that the averments of the original petition and answer and supplemental petition were true and correct, and that the only question for consideration was the right of the plaintiff in error as against the Receiver to set off the demand "it holds as assignee or subrogee of the Gulf, Colorado & Santa Fe Railway Company." (Record p. 19.)

It was further stipulated in said agreement that the foregoing was true, excepting that the averments of the First Supplemental Petition should modify plaintiff's in error answer in the court below to the extent that the statement that The National Bank of Cleburne would be unable to pay any of its creditors anything, should "be taken to mean that said bank will be able, through its Receiver, under the National Banking Act, to pay its creditors not less than 10 per cent and not exceeding 25 per cent of their obligations; otherwise, the facts as alleged in the original petition and the answer of the defendant, and supplemental petition of the plaintiff are to be taken as true

and correct, and the cause submitted to the court on such petition, answer and supplemental petition, excepting only as modified by this agreement."

It is deemed important also to direct the court's attention to the provision in the banker's bond pertaining to its termination. That bond provided that it should be terminated

> "Thirty days after the receipt by the insured of a written notice from the underwriter of its desire to terminate this bond." (Record p. 14.)

There is nothing in any contract provision of either of the bonds, and there is nothing disclosed by the pleadings and the agreement, indicating that there was any understanding, express or implied, between the parties, that any fund created or paid by the Guaranty Company should operate as an offset to either of the obligations. In other words, there was no express or implied agreement for offset, and no circumstances averred from which such an agreement could be inferred.

SUMMARY OF FACTS

As a basis for the argument on behalf of defendant in error, we think the facts controlling this controversy may be accurately and briefly stated, as follows:

On August 24, 1921, The National Bank of Cleburne, with the United States Fidelity & Guaranty Company as surety, delivered to the Gulf, Colorado & Santa Fe Railway Company a bond to secure that

company against loss on deposits or other indebtedness of the bank to that company. This bond provided that it could be terminated by the surety at any time prior to default on giving fifteen days' notice in writing to the railway. There is no evidence that any securities were given by the bank to the Railway to additionally or otherwise protect the railway. There is no evidence that the railway was to have any right whatever in the bond presently referred to. There is no evidence of any connection between the bond delivered to the railway and the bond presently mentioned. The transaction was consummated four days before the execution of the banker's bond presently referred to.

Thereafter, the plaintiff in error issued to the bank what is termed a "Bankers' Blanket Bond" for the purpose of protecting the bank to the extent of $25,000 against embezzlement or other misapplication of its funds by its officers and employees named in the bond, among whom was its president, S. B. Norwood.

The premium for both of these obligations to the Guaranty Company was paid by the bank.

The sum of the obligations was simply that the Guaranty Company said to the Gulf, Colorado & Santa Fe Railway Company, "If the National Bank of Cleburne doesn't pay you, we will." This was a simple contract between the bank, the surety company and the railway company for the benefit of the latter. The other contract merely said as insurance to the bank, "If

Norwood steals your money, we will reimburse you to the extent of $25,000." This bond was for the benefit of the bank, and there is nothing in the record to show that the Railway had any interest whatever in it other than as a general creditor of the bank. The idea is repelled by the bond itself considered at page 81 this brief.

The bank's president, Norwood, misapplied and embezzled the funds of the bank in a very great amount and to such an extent that it was forced into insolvency on the 17th of October, 1921, and defendant in error was appointed its Receiver under the National Banking Act.

After the bank's failure, and on the 16th day of January, 1922, plaintiff in error paid the Railway the amount of its deposit, and on the 24th day of January, 1922, the Railway assigned to plaintiff in error all its right, title and interest in the deposit.

Subsequently this suit was filed, and resulted in a judgment below for the amount of the bond, denying the offset (Record p. 20), which judgment was affirmed by the Circuit Court of Appeals of the Fifth Circuit (Record pp. 22-25), and is in this Honorable Court for review on writ of error.

ARGUMENT

We concur in the statement in plaintiff's in error brief that the sole question for the consideration of the court is the correctness of the judgment below, which involves only the single question of whether or not the court below erred in denying to plaintiff in error the right to offset the amount it paid the Railway, in an action by the Receiver on fidelity bond to recover the amount of $25,000, being a part of the funds misapplied by the president of the defunct bank.

We think that the consideration of this question is best determined by the answer which should be made to the following questions:

1. Can plaintiff in error, by assignment to it, after insolvency of the bank, procure the claim of the railway against the bank and offset same against the demand of the bank on the banker's bond account of defalcations of Norwood?

2. Can plaintiff in error, through subrogation to the rights of the railway, assert the right to set off the claim of the railway against the action of defendant in error on the banker's bond brought by reason of the defalcations of Norwood?

We will consider the foregoing questions, and in doing so will at different places answer the points made in the brief for plaintiff in error.

FIRST—RIGHT BY ASSIGNMENT

We do not understand plaintiff in error to seriously contend that after insolvency of the National Bank of Cleburne, that plaintiff in error would have the right to acquire by assignment a claim against said bank and offset same against the action of the bank or its receiver to recover on the honesty bond of Norwood. We apprehend that counsel merely relies upon this assignment as an aid or adjunct to the asserted right of subrogation.

But, if we are in error as to this, we respectfully submit that it is too well settled to admit of serious controversy that a party cannot by assignment procure a claim against an insolvent bank and offset that against a valid claim of the bank against him.

The rule as stated by *Corpus Juris*, Volume 7, page 849, is as follows:

> "The right to set off must be governed by the state of things existing at the moment of the bank's insolvency; and while a debtor of a bank may set off against his indebtedness a claim against the bank which he held at the time of its suspension, a claim acquired after the bank's insolvency cannot be offset. Where the claims are wholly independent of each other and between different parties, they do not occupy the position of mutual demands between the same parties originating in mutual credit and cannot be offset."

This statement is supported by a large number of authorities and by the decision of this Honorable Court in the case of *Yardley v. Philler*, 167 U. S. 344,

in which this court indicated that the right in such cases is controlled by the principles announced in the case of *Davis v. Elmira Savings Bank*, 161 U. S. 271, which cases will be hereafter reviewed. To like effect also are the following authorities:

> *Mechanics Bank & Trust Co. v. Ernst*, 231 U. S. 60.
> *Hotchkiss case*, 231 U. S. 40.
> *Beckham v. Shackelford*, 29 S. W. 200.
> *Davis v. Knipp*, 36 N. Y. St. 705.
> *First Nat. Bank v. Selden*, 120 Fed. 212, U. S. C. A., January 6, 1903.
> *High Receivers*, 4th Ed., Sec. 249, p. 290.

This position has been thoroughly settled, and in the *Beckham case, supra*, the Court of Civil Appeals of Texas had under consideration such a claim acquired after insolvency as to a national bank.

Should the court desire to make any further investigation, we refer to 6th *Federal Statutes, Annotated*, Article 5242, Section 905, subdivision 6 (said Article 5242 being the Act of June 3, 1864, 13 Stat. L. 603), and there is cited herein, to which we direct the attention of the court, the case of *Selma First Nat. Bank v. Colby*, 21 Wall. 609, and *Scott v. Armstrong*, 146 U. S. 499, which latter case will be hereinafter discussed.

From the authorities cited, we think we are safe in saying that it has been thoroughly settled by this court that on insolvency of a national bank, all rights are preserved as of the date of the insolvency, and no

other rights can be created by either voluntary or involuntary acts, and any act, the tendency of which is to create a preference, is void.

SECOND—RIGHT OF SETOFF THROUGH SUBROGATION

Before considering this part of the contention of the plaintiff in error, we believe it would be important to keep in mind something of the nature of the equitable right of subrogation and equitable setoff which may be allowed as a result of subrogation, and to consider the real nature of the obligations involved.

For a consideration deemed adequate by the Guaranty Company, it undertook to protect the Railway Company against loss as a depositor of the bank. It undertook this prior to the execution of the banker's bond. It is obvious that there was no express or implied agreement that one obligation was to in any way protect the other, but they are separate, distinct and unrelated transactions. They were executed at different times for separate and distinct purposes, and the very purpose of one of the obligations will be defeated if plaintiff's in error contention prevails.

In some instances, courts of equity do extend quite liberally the right to setoff, but we venture the assertion that no case can be found where a court has extended that to a surety or guarantor, or anyone else, where such party had the right to say whether he would or would not be bound, but have extended the principle to sureties where they had no choice, but

even then, the right is not extended further than possessed by the subragor.

In the present instance on the bond of the bank to the railway, the surety had the right to terminate that bond at any time prior to default on fifteen days' notice, and likewise, plaintiff in error was careful to preserve to itself the right to terminate the banker's bond thirty days after notice to the insured. In other words, at all times it had the right to elect whether it would or would not continue to be bound, a right never possessed by an ordinary surety.

It will therefore be observed that the liability of plaintiff in error on said bonds was contingent, uncertain in amount and not absolute. We submit that the bond to the railway, under well-defined principles, was a mere guaranty obligation. The liability of the surety was secondary and collateral to that of the principal, and in all respects, that of a guarantor, R. C. L., Vol. 21, page 949.

Stearns on Suretyship, 3rd Edition, page 5, speaking of the distinction between a surety and a guarantor, says:

> "A surety undertakes to pay the debt of another; a guarantor undertakes to pay if the principal debtor does not or cannot. A surety joins in the contract of the principal and becomes an original party with the principal; a guarantor does not join in the contract of his principal but engages in an independent undertaking. A surety promises to do the same thing which the principal undertakes; the guarantor promises that the

principal will perform his agreement, and if he does not, then he, the guarantor, will do it for him. The liability of the surety is immediate and direct; he agrees that he will perform the principal contract, fixing upon himself the responsibility from the beginning. If, however, the promise is that the principal will pay or that the debt is collectible or that the principal is solvent, then the liability is not immediate and does not fix upon the promisor a liability from the beginning, but only upon default or failure of the principal to do what it is agreed he shall do. In such a case the promisor is a guarantor.

"Both the surety and guarantor agree to pay the debts of another, but the liability to pay in the case of the surety starts with the agreement, whereas, the liability of the guarantor does not start with the agreement except as a contingent liability, and is established for the first time by the default. The contract of the surety is more burdensome to the promisor than the contract of the guarantor, the promise of the latter's contract in some cases giving him the benefit of notice and the right to require the creditor to exercise diligence in pursuing the principal, advantages which the surety never has."

We submit that this becomes important in determining the right of plaintiff in error to subrogation under the circumstances of this case, and demonstrating that there was no absolute obligation on the part of plaintiff in error to pay from the beginning. And especially important in determining the pure equitable right of subrogation, for that is an equity pure and simple, which, before it is granted, must appeal to the con-

science of the chancellor and not work wrong or injustice on other parties. Under such circumstances, it is submitted that plaintiff's in error right should be tested from the time it was called upon to perform, rather than from the beginning of the transactions, which will be more exhaustively treated later.

The parties to the obligations were not the same, there was no relation or connection between the issuance of the bonds, but they were executed for separate and distinct purposes. There was no mutuality of credit, there was no deposit to the credit of the insurance company in the bank, and no obligations on the part of the bank to the insurance company other than such as might arise under the first bond.

At no point was there an agreement for setoff, and it is obvious that no such agreement could be implied. But to the contrary, the status of the parties, the objects to be attained, the considerations paid, clearly repel the idea that under any circumstances one of these obligations was to be discharged on the payment of the other. Moreover, it is agreed that the bond upon which this suit was brought was "to indemnify The National Bank of Cleburne against the alleged wrongful acts of its president"; and it is further agreed that said bond "became and is an asset of the bank and a trust fund for the purpose primarily of paying off and discharging, so far as it will, the liabilities of said bank to its various creditors in exact proportion to their respective claims," (Record p. 18, averment in supplemental petition, and Record p. 19, stipulation regarding facts).

If there is any doubt as to the proper construction of these instruments, it should be resolved against the plaintiff in error. *(Pauly v. American Surety Co.,* 170 U. S. 160.)

Now, under the circumstances outlined, and before plaintiff in error can come into a court of equity and procure the right of subrogation and an equitable setoff, it occurs to us that it would be proper to recall some of the underlying principles which control those rights.

Mr. Bishpam in his work on Equity, 10th Edition, Sec. 338, speaking of subrogation and quoting Chancellor Kent, says:

> "This is a rule founded on natural justice and I believe is recognized in every system of jurisprudence * * * * it rests on the basis of mere equity and benevolence."

Chancellor Johnson said:

> "The doctrine of subrogation is a true unmixed equity having its foundation in principles of natural justice."

This latter quotation is cited twice with approval by this court in cases referred to by Bishpam. Again, this authority says that the doctrine "*must not be enforced to the detriment of equal or other superior equities in other parties*" and "*will not be enforced against a legal right.*" Subrogation is not a matter of strict right, but is purely equitable in its nature, and being a creature of equity, it will not be enforced where it will work injustice to the rights of those having equal

equities. *First National Bank v. City Trust Saving Deposit & Security Company*, 114 Fed. 529-533; C. C. A. 9th Circuit, decided Feb. 24, 1902; *Portland Mills v. Portland*, 145 Fed. 687-691, District Court of Oregon, decided March 19, 1916; *National Surety Co. v. State Savings Bank*, 14 L. R. A. (N. S.) 155.

Again, equity violates no law, and where the surrounding circumstances and contracts are such as to show no subrogation was intended to result, it will not result, and a subrogee can enforce no rights the creditor could not enforce. 5 *Pomeroy Equity*, Section 2349, page 5198.

In Volume 24, R. C. L., page 858, the following language is used:

> "Setoff ex vi termini implies reciprocal demands existing between the same persons at the same time, and it is the well-settled general rule that a demand to be the subject of setoff must be mutual between all parties to the action; that is, the claim must be due to and from the same parties and in the same capacity. It must be such a demand as that the defendant in his own name or in the names of defendants sued, without bringing in the name of a stranger to the suit, may maintain an action of debt or indebitatus assumpsit on it against the party or all the parties suing, as the case may be. Less than that is not mutuality."

It is respectfully submitted that the facts heretofore outlined clearly demonstrate that no subrogation was intended to result, and that the very terms of the instruments themselves demonstrate the fact that they

were intended to accomplish certain specific and definite results, and that there was no intention whatever on the part of the parties that one of them should be used as a means of avoiding payment of the other.

Again, in Volume 25 R. C. L., page 1321, the following language is used:

> "Equity violates no law, and it does not assume to make a contract for the parties; it follows the law and upholds it, and when it comes to relief of one to whom the law cannot afford an equity remedy, it will not in so doing infringe the law or impair its force, nor will it restrict the contract between the parties. Accordingly, where the terms of the contract and the conditions arising from its performance are such as to show that the parties did not intend that subrogation should result, in such case it will not result. Equity will not ingraft its doctrine on the transaction in the face of a contract that negatives the idea of subrogation."

And again, the same paragraph:

> "Subrogation is the creature of equity and will not be permitted where it will work injustice to the rights of those having equal or superior equities, or where it will operate to defeat a legal right."

Again, the old established rules that obligations sought to be set off must be mutual and enforcible prior to receivership. 4 *High Receivers*, Section 364-A; *Pomeroy Equity*, 4th Edition, Section 1608, page 3796, and Section 1609, page 3797. We think it

may be safely said that in bankruptcy proceedings, and in all other insolvency proceedings in whatever form they may take, the principle is thoroughly established that all rights and equities are preserved as of the time of insolvency, or as some authorities express it, the moment of insolvency. No changes can thereafter be made so far as the assets of the insolvent's estate are concerned, whether through assignment, bankruptcy proceedings, receivership proceedings or any other method. All rights are preserved as of the time of insolvency, and we are not aware, and have been unable to locate any authorities which permit the right of setoff to be acquired through the fact of insolvency itself as the "same transaction" or through any subsequent act on the part of parties as against the claim of creditors.

We think it obvious that the setoff claimed in this case is a mere cross demand, which is wholly insufficient to justify a setoff in equity *(Story Equity Jurisprudence,* 10th Edition, 1436). Now it will be observed from the contention made in the brief of counsel for plaintiff in error, and as a result of the cases to which he directs the attention of the court, that the main basis of the contention of plaintiff in error is that equitable setoffs should be permitted by reason of the plaintiff in error being subrogated to the *rights* of the railway.

To clarify the situation at this point, we inquire what were the *rights* of the railway at the moment of insolvency? If it had any securities belonging to the bank, plaintiff in error would be entitled to those; if

it had any other collateral to secure the obligation to pay it, plaintiff in error might be entitled to those; and clearly and righteously when plaintiff in error paid the railway, it had the right to step into the railway's shoes and share ratably as provided by law in the assets of the bank; but it is submitted that it had no other or higher rights. It had only the right to such securities and such rights and such remedies as the railway itself possessed. It did not have the right to some remedy never possessed by the railway. At the moment of insolvency, or prior thereto at any date subsequent to the execution of the bonds, what kind of standing would the railway have had in any court of law or equity in asserting any character of right, claim or demand based upon the bond or insurance policy executed by plaintiff in error to the bank, when it was not a party to that contract, it paid none of the consideration for that contract, and the contract was not executed for its protection any more than it was executed for the protection of all creditors. Most assuredly, it had no right whatever in said bond and could enforce none, and how the insurance company can step into its shoes and procure rights it never possessed, and that in accord with equitable principles, we are unable to see.

Not only is this true, but should the contention of plaintiff in error be sustained, it most obviously violates one of the plainest and favorite maxims of equitable jurisprudence, to-wit, "Equality is equity," in that it seeks to take an asset of the bank in which it has no higher rights than any other creditor and ap-

propriate that asset to its own use and benefit, and not give to the other creditors their equal and just proportion of the same. When carefully analyzed, we think the position abhorrent to a court of equity.

With these basic principles in mind, we will discuss some reasons, among others, with citation of authority demonstrating why neither subrogation nor equitable offset should be allowed in this case, after which we will review the authorities cited by plaintiff in error.

Setoff should be denied because the plaintiff in error in possession of a claim owing originally to the Gulf, Colorado & Santa Fe Railway Company, and to secure which one of the bonds was given, is contending for subrogation and offset as to a right never possessed by the railway.

We believe that a grasp of the situation at this point, without giving further reasons, is a complete answer to the position taken by plaintiff in error. We do not contend that plaintiff in error is not entitled to be subrogated to the *rights of the railway.* The trouble with plaintiff in error is that it desires to be subrogated to *rights never possessed by the railway.* Under the statement of "subrogation to remedies," plaintiff in error seeks subrogation to a remedy never possessed by the railway.

We have above discussed this situation to some extent. What was the relation of the railway to the bank; what rights did the railway have against the

bank; what remedies did it have; it was a simple depositor in the bank. The simple relation of debtor and creditor existed between them; it had the right to demand its $23,000 on deposit, and it was the duty of the bank to pay it. If the bank failed to pay it and was solvent, it had the right to force the bank to make the payment. If the bank was unable to pay it or insolvent, or as the facts are, able to pay it only partially, then its rights are best stated in the words of the Supreme Court of Alabama in the case of *Oats v. Smith*, 57 Sou. 439:

> "After insolvency is established, a creditor's claim so far as the assets are concerned, gives him no more than the right to file his claim seasonably and share ratably in their disposition, and when he assigns his claim to another after insolvency is established, the assignee acquires no other or higher right than had his assignor."

This court, in cases to which reference will be made, has indicated the same rule, and furthermore has, in the plainest way, indicated that the balance is struck prior to insolvency; that the courts merely give effect to what has already been accomplished by the law and declared that as owing only, which represents the balance. We think we have shown that the railway had no rights whatever as to the banker's bond, had no cause of action that it could maintain, no right of any nature that it could assert, and hence when it became an obligation by reason of the defalcation of Norwood, it was an obligation to the bank only, in which every creditor had a prorata interest. To hold other-

wise would open the door to all kinds of fraud and preferences. This position may be tested by simple illustration. Suppose that instead of becoming a defaulter to the extent of a million or more, Norwood had only become such as to a few thousand dollars, which would not impair the capital of the bank nor affect its solvency. Could it be contended for a moment that the railway had any interest in this banker's bond? If it did not have under such circumstances as indicated, how did it procure such interest so that plaintiff in error could be subrogated thereto?

Now it has been settled definitely that a party subrogated to the rights of another, has no other or different rights than the party who formerly possessed them.

The Supreme Court of Texas in the case of *Bank v. Ackerman*, 70 Texas 315, says a party subrogated is "regarded as constituting one and the same person with the creditor whom he succeeds."

We again ask, what right did the railway have in the banker's bond to which plaintiff in error might succeed?

Ruling Case Law, Vol. 25, Sec. 60, page 1377, announces the rule as follows:

> "A subrogee is, generally speaking, placed in the precise position of the one to whose rights he is subrogated, and is entitled to all the rights and securities and the benefit of all the remedies which were available to such person, though in a few jurisdictions he is limited to collateral securities. It follows from the very principles of

the doctrine of subrogation that one cannot succeed to or acquire any claim or right which the person for whom he is substituted did not have, the extent of his remedies and the measure of his rights being controlled by those possessed by the creditor, and those rights, claims and securities to which he succeeds are taken subject to the limitations, burdens and disqualifications incident to them in the hands of his predecessor. Beyond this, he has no right and no valid claim for protection."

And again, Section 64, page 1381:

> "The surety's right of subrogation to securities held by the creditor is subordinate and not superior to the rights of the latter. His right is to be put *in the same position* as the creditor, *not in a better one.*" (Italics ours.)

We inquire if the subrogee in the present instance is seeking not to be put "in the same position" but to be put in "a better one."

The text above quoted is sustained by a decision of this Honorable Court in the case of *Phoenix Insurance Co. v. Erie & Western Transportation Co.*, 117 U. S. 312, in the following language:

> "Nor does this conclusion impair any lawful rights of the insurer, his right of subrogation arising out of the contract of insurance and payment of the loss is only to such rights as an assured has by law or contract against third persons."

The position is also sustained by the Supreme Court of California in the case of *March v. Barnett*,

121 Cal. 419; 53 Pac. 933; and also the case of *Peagler v. Davis*, 143 Ga. 11; 84 S. E. 59, where the court finds the right of subrogation to the rights only possessed by the subragor, saying:

> "Under subrogation the claimant is entitled to no other or different remedies than those of the creditors to whose rights he is subrogated, even though the property be proved to have been worth no more than the liens which he discharged."

We think the term itself clearly connotes that the rights only held by the subragor pass and none other, and that he does not by subrogation procure some separate, distinct right through some other source under the claim that he is subrogated to the remedies of the railway and can therefore assert any right that it could acquire not possessed by the railway, and in that way bring about a setoff.

We think it obvious that in the present controversy plaintiff in error seeks to be placed in a higher position and a better position than was the corporation in whose shoes it stands. The railway had no such rights. Under the facts as they actually existed, its rights were simply to present its claim and share with the other creditors in the assets of the estate. That was just "Equality is equity." We are not contesting the right of plaintiff in error to take that stand, but we are contesting the right of plaintiff in error to take such a stand and then pay off and discharge obligations of $48,000 by a payment of $25,000 and assert through subrogation a right never possessed by the railway. And to do all of that through

a court of equity to the detriment, injury and loss of others with equal rights to those of the Railway, simply because they had not procured a surety company to guarantee their obligations. If such a practice is tolerated, it would be extremely dangerous for a bank to have more than one transaction with a surety company, and more dangerous for any depositor, unless protected, to place any money in a bank. It would simply enable the Insurance Company to collect two premiums for two obligations and discharge them both on payment of one, and this in a court of conscience.

Subrogation is peculiarly a child of equity. It is used only when the conscience of the court requires it to be used to do natural right. What kind of a conscience is it that takes all of the assets belonging to all of the creditors (as might readily occur) and apply them all to the satisfaction of the debt of one creditor, who, before insolvency, had no such right. And that too to satisfy an insurer who, for a good consideration, assumed the obligation as to both debts? We are at a loss though to know how plaintiff in error would accomplish a result it now seeks, if the bank had been rendered insolvent by a storm or fire, or in some other way not covered by the banker's bond. If the grounds of setoff exist in this case, it should exist in the one supposed, because setoff is a mere striking of balances, giving effect to a result already accomplished. And if there is one principle more than another that is firmly established in all such cases, it is that the right of setoff must be in existence prior to insolvency.

But another peculiar situation arises if the bank had been rendered insolvent by the act of a burglar rather than one of its officers. In this instance, according to plaintiff's in error theory, a $25,000 bond protecting the bank against burglary, and incidentally all of the creditors, must be set aside and applied to the debt of one.

We think it obvious that the very contracts themselves repel the idea of subrogation or that it was ever intended; that the right of setoff did not exist at the moment of insolvency, and hence it must have been brought about by reason of conditions created subsequent to insolvency, and of course this latter cannot occur, but leaves the plaintiff's in error rights as a mere cross demand which must share only in its pro rata part of the assets of the bank.

Again:

Setoff should be denied because it does not arise in the same right nor from the same transaction and lacks mutuality.

We of course do not deem it necessary to cite authorities on the proposition that in order for an equitable setoff to exist, there must be mutuality in accounts; that the right must arise from the same transaction.

We think we have said enough heretofore to indicate to the court that there is no connection whatever between the two transactions taking place prior to

insolvency. The National Bank of Cleburne bought and paid for a bond to protect the Railway Company against loss on deposits. Probably it could secure the deposits of the railway in no other way; at least, we think this is a legitimate inference.

There is no connection whatever between that and the act of the bank in buying an insurance policy protecting that institution against misapplication of its funds by its officers. This latter is clearly made for the benefit of the bank, and not for the benefit of the railway, whose obligation had already been executed. This latter bond is clearly and admittedly a trust fund to pay off and discharge the claims of creditors. The right of these creditors, we think, is clearly manifested by the terms of the statutes of the United States pertaining to insolvent national banks. All authorities seem to concede that there must be either an express or implied understanding to bring about setoff; that the parties at the inception of the transaction must have contracted with the view of having mutual obligations to each other, and the balance owing at any time would be the debt.

The wildest flight of imagination could hardly say that the bank took out the obligation to secure it against the dishonesty of its officers for the purpose of paying off and discharging an obligation that the bank would be owing to the Gulf, Colorado & Santa Fe Railway Company. The bank might have failed from bad loans. The railway would have been fully protected, but most assuredly there would have been

no right of subrogation other than to take the claim of the railway and share ratably in the distribution of assets. Under that condition, the president may have been as innocent as a lamb, as all of the other officers. Here there could be no possibility of offset. In order for there to have been any understanding about offset, it must have been in the minds of the parties at the time the bond to the bank was executed that it was probable that Norwood, or some other officer would rob the bank so as to render it unable to pay the railway, and that the insurance company would pay the railway, but in doing so, would avoid paying the bank what it had contracted to pay on the banker's bond. It is hardly probable that any such idea was in the minds of the parties, and if it was, it was a simple plain fraud on the rights of other depositors and creditors. A court of equity would hardly enforce it. It seems obvious that no understanding or agreement for offset existed or could be implied, and without it, there certainly couldn't be mutuality.

This court in the case of *Scott v. Armstrong*, 146 U. S. 499, which will be hereafter more fully reviewed, indicates plainly that such setoffs are usually matters of contract, and that the parties intended to meet the obligations with mutual credits.

We think it equally obvious that these contracts did not arise in the same right nor from the same transaction. They are separate and distinct contracts; there is neither identity of subject matter, nor identity of parties, nor identity of purpose in the

two obligations. There is nothing in the transactions to indicate that one of them was to operate as a discharge of the other. The railway certainly had no interest in the world in any of the transactions other than to protect itself as a depositor. The bank had no other interest than to protect itself against dishonesty of its employees, and plaintiff in error had no other interest than to get all the premiums that it could from the bank for asuming the obligations it did assume.

In truth, except for insolvency, there could not have been any contention of the right of offset, and the situation in our judgment demonstrates conclusively the lack of mutuality. And paraphrasing the words of this Honorable Court in the case of *Yardley v. Philler*, 167 U. S. 354, would—

> "amount to the assertion as a proposition of law that the insurance company would have greater rights in consequence of the insolvency than it would have if the insolvency had not taken place. The self-evident error of this proposition points to the unsoundness of the claims of the insurance company in the controversy."

The original words of the Supreme Court in that case are as follows:

> would "amount to the assertion as a proposition of law that they both have greater rights in consequence of the insolvency than they would have had if the insolvency had not taken place. The self-evident error of this proposition points to the unsoundness of the claims of both parties to the controversy."

The case referred to will be reviewed hereafter and deals with the matter of offset. But plaintiff in error urges that these contracts did arise out of the same transaction, to-wit: the embezzlement of the funds of the bank by Norwood, and the consequent insolvency of the bank.

We do not believe that able counsel for plaintiff in error has stopped to analyze that position or he would doubtless not have taken it. Neither the railway nor the insurance company were parties to the defalcation of the president of the bank. Certainly, the parties did not get together and agree that that course should be pursued. It is a strange doctrine that would make parties responsible and fix their rights by acts of third parties, over which they had no control. Rights of offset arising from the same transaction of course refer to the transaction between the parties, and not to some third party's transaction.

It strikes us that it would be ridiculous, in the light of the insolvency laws, and in the light of the statutes of the United States with reference to ratable distribution to creditors, to allow such contention as plaintiff in error now makes, that the transactions out of which the mutual credits arose (as contended by it) were not the acts of the parties themselves to that credit or to those credits, but was brought about by the act of a defaulter in absconding with the funds of a bank and rendering it insolvent. When neither the bank nor the parties who claim a setoff by virtue of such transaction, nor the railway who held the guaranty obligation, had anything to do with

it. It would be a strange rule that would bring about rights of setoff under such circumstances as that, when such rights did not exist by the acts of the parties themselves. Mutual obligations most assuredly imply some character of understanding between the parties, but such a rule would require them to anticipate the wrongful act of a third party, as being sufficient to completely change their status among themselves.

The absurdity of this situation may be further illustrated by supposing that an insurance company had issued a policy on a bank against tornadoes. It had also become an obligor or surety on a bond of the bank to secure one of its depositors. The bank is destroyed by tornado and rendered insolvent. According to plaintiff's in error theory, that would be the act which would render the obligations mutual, as arising from the same transaction, to-wit, the tornado; and the insurance company, upon paying one depositor, could take the only asset of the bank left to reimburse itself as against the claim of all other creditors.

Again, suppose the bank or its officers, after insolvency, undertook to take the banker's bond and assign same to the railway company in payment of the deposit the railway company had with the bank. Could it be doubted that such would be an improper application of the assets of the bank as against other creditors? Could it be doubted that such would be a preference to one creditor against others in violation of the laws of the United States, and yet, in

logical effect, that is the very thing for which plaintiff in error is contending through equitable subrogation. Plaintiff in error contends that it is entitled, in the shoes of the railway, to apply an asset of the bank to a debt of the railway, and thereby do indirectly what it could not do directly.

And again, in any view taken, the contention of plaintiff in error becomes more obvious that it is seeking to pay off and discharge $48,000 in obligations, which it was paid to assume, by the payment of $25,000.

We think it obvious that if the right to setoff did not exist without insolvency, insolvency could not bring it into existence. It is merely the law doing what the parties had a right to do. If, at the moment of insolvency there is no debt, there can be no setoff. If there had been no insolvency, there could not possibly have been any failure to pay the claim of the railway; hence plaintiff would have had no right to that claim, though plaintiff in error may have been responsible on the banker's bond.

Again:

The right of setoff should be denied, because to allow the same would create a preference as to the claim of the Gulf, Colorado & Santa Fe Railway Company in violation of law, and would be inequitable to creditors with better claims to protection than plaintiff in error.

Under the Federal statutes, all rights are preserved as of the date of insolvency, and no other right can be created by either voluntary or involuntary acts. Any act, the tendency of which is to create a preference, is void. (6th *Fed. Stat. Ann.* page 905, subdivision 6, Article 5242, page 904, the Act of June 3, 1864, 13 Stat. L. 603.)

We think it obvious that in the National Banking Act, in the event of insolvency, the prime purpose of the laws of Congress is to handle the assets in such a way as to make a ratable distribution among the creditors of the bank, and anything that tends to create a preference is void.

If what has been done in this case could have that effect, it would simply open the field wide for fraud upon creditors and the protection of favorite depositors.

This Court, in the case of *Scott v. Armstrong*, 146 U. S. 499, says:

> "Undoubtedly, any disposition by a national bank being insolvent or in contemplation of insolvency of its choses in action, securities or other assets made to prevent their application

> to the payment of its circulating notes or to prefer one creditor to another, is forbidden, but liens, equities or rights arising by express agreement or implied by nature of the dealings between the parties or by operation of law prior to insolvency, and not in contemplation thereof, are not invalidated."

Whatever view we take of the facts of this case, should this offset be allowed, it unquestionably results in a preference to the claim of the Gulf, Colorado & Santa Fe Railway Company or its assignee. That company will be paid in full. Other creditors will receive not over 25 cents on the dollar. The effect of the arrangement brings about a clear preference, whether intended or not (and it is presumed to be intended, *Davis v. Bank*, 161 U. S. 275). The effect of the arrangement is to allow the railway company, a simple creditor so far as the assets are concerned, to be preferred and paid, not from the contract of guaranty on which plaintiff in error was liable, but from the assets of the bank which belonged to all of the creditors alike, and this just as fully to all intents and purposes as if the actual cash was taken from the bank's vaults and turned over to the railway.

We think it so obvious that at the moment and prior to insolvency, there was no right of offset existing, and under the authority of Scott v. Armstrong and many other cases, some of which will be reviewed hereafter, none can thereafter be created.

We deem it important in this connection to refer this Honorable Court to a well considered decision

of the Supreme Court of Michigan in the case of *Stone v. Dodge*, 56 N. W. 77, from which we quote as follows:

"The object of section 47 is to secure a proportionate division of the assets of the bank between its creditors, and to prevent preferences. By force of this section, upon the commission of an act of insolvency the assets of the bank become actually impounded for the benefit of creditors. If a debtor can connive with his particular friends who may happen to have deposits in the bank, and a number of the debtors might do the same thing, the very object of this provision may be frustrated. It cannot be contended that the officers of the bank, after its suspension, could have received this certificate of deposit, and surrendered defendant's obligation. That obligation was an asset of the bank, and the effect of that transaction would have been to prevent its application in the manner provided by the act. The law will not allow or compel the receiver to do what it expressly prohibits the bank from doing. Diven v. Phelps, 34 Barb. 224; Venango Nat. Bank v. Taylor, 56 Pa. St. 14.

"In Diven v. Phelps the bank suspended business, closed its doors, and was insolvent on the 21st of September. The receiver was appointed November 9th, following. In the meantime, defendant had procured certain bills of the bank, which he undertook to offset to a claim in favor of the bank. The court says: 'The bills, having been obtained after the bank had suspended and became insolvent in effect, could not, I think, be used as a setoff. The bank could not then have paid this demand in any way. It was abso-

lutely prohibited by suit from so doing. If the bank, before the appointment of the receiver, had given up the defendant's note in satisfaction of his claim as holder of the bills, the transaction would have been void, and the note thus given up might have been recovered of the defendant as part of the assets belonging to such bank or the creditors thereof. Before the defendant procured his bills, the bank held the note against him, and, the latter being insolvent, the note belonged equally to all the creditors of such bank. If the deefndant could be allowed to purchase or receive the bills of the insolvent bank, and with them satisfy, and thus take from the assets, this amount, or any other, the policy of the statute, which is to secure perfect equality among all the creditors of insolvent corporations of this description, would be entirely defeated.' In the course of the opinion the court refers to 1 Rev. St. p. 591, Sec. 9. That section is as follows: 'No such conveyance, assignment, or transfer, nor any payment made, judgment suffered, lien created, or security given, by any such corporatoin when insolvent, or in contemplation of insolvency with the intent of giving a preference to any particular creditor over other creditors of the company, shall be valid in law; and every person receiving, by means of any such conveyance, assignment, transfer, lien, security, or payment, any of the effects of the corporation, shall be bound to account therefor to its creditors or stockholders, or their trustees, as the case shall require.' In the case of Venango Bank, Taylor owed the bank $35,000. One Rynd had in the bank a deposit of $44,000. The bank, being insolvent, stopped payment. The next day Rynd assigned his deposit to Taylor. Held, that

Taylor could not set off the deposit against his indebtedness to the bank, as it would give a preference to one creditor of the bank after the act of insolvency. The court discusses the Act of Congress of June 3, 1864, and especially section 52 of that act, which is substantially the same as section 47 of our own statute, above quoted. The court says: 'The bank is a creature of the act, depending upon it for all its powers, and controlled by all the restrictions the act imposes * * *. It provides a system for closing the affairs of an insolvent bank, the design of which is to place all creditors, except the government and note holders, on an equal footing. Its purpose is to disallow preference of one creditor over another, and it denies the power to make such preference at any time after an act of insolvency.' Section 52, read in connection with section 50, 'admits of no doubt that the purpose of Congress was to secure all the assets of the bank existing at the time of its acts of insolvency for ratable distribution. We cannot assent to the argument that it was intended for no more than to avoid all acts of the bank itself, all voluntary transfers by it with the view of giving preference. Its language is general, as applicable to legal as to voluntary transfers. If the deposit can be set off against the bond debt, what is it but a transfer of the bond debt to the satisfatcion of the creditor, thus giving him preference. It is not contended that the bank was not prohibited from doing this, but it is insisted the transfer may be accomplished by an adverse proceeding at the suit of Rynd for the use of Taylor. It is not denied that Rynd, had he made no assignment of the claim, could not have obtained payment of the debt due by him

> by calling upon the bank after its doors were closed, and when it suspended payment. The bank was not at liberty to transfer to him either their claims against Taylor or any of their assets, or to pay him any money; and, if so, can the thing be secured by a hostile proceeding? Will the law compel a payment or a transfer which the law prohibits a debtor from making? If Rynd could in no way have obtained payment of the deposit due him except through the comptroller of the currency, how could he give to Taylor, by his assignment of the deposit, any right which he did not himself possess?"

If, in that case the officer of the bank could not have surrendered defendant's obligation, how in this case could the receiver or the officers of the bank, after insolvency, turn over to the insurance company or to the railway company the obligation of the insurance company, thereby creating a preference to the Gulf, Colorado & Santa Fe Railway Company? Clearly, neither the receiver nor the officers of the bank in the present matter could have surrendered the bond of the surety company as to Norwood to the railway company, or any other creditor without having the result of the payment of that creditor to an extent not secured to other creditors, and hence in violation of the Federal statutes. The provision of the statute in the Michigan case is practically the same as the Federal statute under consideration.

We think the argument of plaintiff in error proves too much. It leads almost irresistibly to the conclusion in its ultimate effect of allowing in equity a dis-

honest officer of a bank to rob his institution and through that dishonesty to give a party rights against other creditors he would have never had except through the wrongful act of the officer. We don't think a case can be found where a court of equity has knowingly permitted a situation of that kind to stand.

In some of the cases cited by plaintiff in error, to which attention will be presently directed, the courts have stated that plaintiff in error stands in the shoes of Norwood, that is, he is Norwood's surety, who has guaranteed the bank against the wrongs of Norwood. Would a court of equity listen to Norwood very long if he were sued for recovery of funds that he had taken wrongfully from a bank while he was its officer, and in order to avoid the restoring of the funds to the party to whom they belonged, assert that he had certain offsets against the bank and ask the court to allow those offsets. Would not a court of equity rather say to him, "You restore those things you have taken wrongfully first. You have no standing in a court of equity until you do that." With no improper reflection, but righteously, plaintiff in error must occupy that position. It has stood sponsor for Norwood. It has said to the bank and to the creditors of the bank, "If he embezzles the funds of this institution, we will repay." Should it not be required to stand in that position until it makes good its contract, just the same as Norwood would be compelled to stand?

In the case of *National Security Bank v. Butler*, 129 U. S. 223, this court had under consideration an attempted setoff growing out of the failure of the

Pacific Bank. That bank, on May 13, 1882, had given a certificate of deposit to the National Security Company for $10,000. On May 20th the Pacific Bank closed its doors. Previously, the Pacific Bank had no means of making clearings and it had turned its collections over to the Security Bank to be put through the clearing house, and on the 20th of May owed the Security Bank on open account, $40.25, besides the certificate of deposit. On the 22nd of May some returns coming to the Pacific Bank after it had closed its doors as insolvent, it transferred and delivered to the Security Bank certain drafts, bills, checks and other property, which, with the $40.25 owing the Pacific Bank, made a total of $11,008.20. The Security Bank gave the Pacific Bank a certificate of deposit for that amount on May 22nd. The receiver of the Pacific Bank sued the Security Bank to recover the items mentioned as a preference and by reason of the fact that the Security Bank would attempt to offset same against the amount owing it by the Pacific Bank on the first certificate mentioned. This court held that the right of offset did not exist; that it was a plain preference, and affirmed the judgment.

Here if an attempt had been made to deliver the bond in question to the Gulf, Colorado & Santa Fe Railway Company in satisfaction of the bank's obligation to the railway, it could have been nothing else but a preference, for it is taking assets of the bank belonging to all of the creditors and applying it to the debt of one creditor.

In the case of *Mechanics Bank v. Ernst*, 231 U. S. 60, the bank had loaned Fisk & Company, early on the morning of the day on which that company failed, $400,000, and credited same to the account of that company and on which there was already a balance of over $36,000. By noon, the bank certified and paid checks of $275,000, then, hearing of trouble with Fisk & Company, the bank stopped payment of checks, the cashier went to Fisk & Company's office and demanded from Fisk & Company some securities. Securities were put up to the bank, all of which had come from the money loaned that morning. Shortly after noon Fisk & Company failed. Shortly after three o'clock an involuntary petition in bankruptcy was filed against them and this suit was brought against the bank for the proceeds of the securities which had been given the bank as above indicated. This court sustained a judgment against the bank, holding that the securities thus given were clearly a preference and denying setoff. And to like effect is the case of *National Bank v. Hotchkiss*, 231 U. S. 50.

Suppose the bank in the present instance had delivered to the railway company the bond in question in satisfaction of the deposit of the railway at the time of or after knowledge of insolvency. Could it be doubted for a moment that such would be a preference as against other creditors?

Again, the record shows that besides the debt of the Gulf, Colorado & Santa Fe Railway Company, there were debts of various creditors to the extent of over two million dollars, in the main being depositors.

Certainly these depositors equitably have rights in the assets of the bank. Certainly they have a right in the bond which it is agreed is a trust fund for the payment of all creditors. Certainly equity, either under principles of equitable setoff or on principles of subrogation would not allow a setoff where it results in injury to others with equal or greater equities, hence, even though the plaintiff in error should have any equities, those equities should be denied where they result in the injury of others. 25 R. C. L. Sec. 9, page 1321; Section 4, page 1314.

In the case of *Wasco v. New England Insurance Company*, 172 Pac. 126, a case cited by the plaintiff in error, in which the following quotation, also cited by this court in the case of *Aetna Life Insurance Company v. Middleport*, 124 U. S. 549, is used:

> "The doctrine of subrogation is a pure, unmixed equity having its foundations in the principles of natural justice, and from its very nature never could have been intended for relief of those who were in a condition in which they were at liberty to elect whether they would or would not be bound, and as far as I have been able to learn in its history, it never has been so applied. If one with a knowledge of the facts will part with his money or bind himself by his contract in a sufficient consideration, any rule of law which would restore him his money or absolve him from his contract would subvert the rules of social order. It has been directed in its application exclusively to the relief of those who were already bound who could not but choose to abide the penalties, sureties for example, who have become

> bound are amongst the special objects of its care. Thus if a surety pays the debt of his principal, he is entitled to stand on the place of the creditor and to have the benefit of all securities, funds, liens and equities to which the creditor was entitled."

The plaintiff in error in this case bound itself by a sufficient consideration to pay the sum of $48,000 on these obligations. It now, through principles of subrogation, seeks to avoid the payment of other than $25,000, thereby absolving itself from its solemn contract, and nothwithstanding the fact that we are willing to concede that plaintiff in error is entitled to the securities, funds, liens and equities to which the Gulf, Colorado & Santa Fe Railway Company is entitled. Still plaintiff in error is not satisfied with that but wants to avoid the payment of its solemn undertaking, and that through principles of equity and against many sufferers in the failure of this unfortunate institution.

Again:

Because plaintiff in error was a surety for the defaulting president, Norwood, of the National Bank of Cleburne, and so far as a court of equity is concerned, stands in the position of Norwood and has no right to demand setoff or subrogation until it first restores to the place where it belongs the funds that were unlawfully taken by Norwood.

It is conceded that Norwood was an embezzler of the funds of the National Bank of Cleburne in large

amounts, much in excess of the amount of the bond sued on; in fact, so much so that his own wrongful conduct was the cause of disaster to the bank and its creditors. Norwood was an officer of the National Bank of Cleburne. As such he had charge of its assets. His duty as a trustee was plain, and that was simply to preserve those assets for the benefit of the institution itself and primarily for its creditors. He breached that trust, wronged the very people who trusted him. Now the plaintiff in error insurance company is in the position of saying to the bank and to its creditors, "Norwood is an honest man. Norwood will not embezzle your funds, but if he does, the insurance company will restore those funds for the benefit of the bank and primarily for the benefit of its creditors." Thereby the obligation of the insurance company is likewise with that of Norwood, a trust in behalf of primarily the creditors of the institution.

We have heretofore directed the court's attention, in considering the ground of preference, as to the standing Norwood would occupy when sued by the bank to recover embezzled funds and endeavor to offset such a claim with claims he might have against the bank. What reason is there why plaintiff in error, in the light of such wrongs, should demand in a court of equity the right to settle obligations of $48,000 by the payment of $25,000? In good conscience, should not a court of equity require plaintiff in error to comply with its contract to restore the funds to the place they belong, to step into the shoes of the railway com-

pany and take the results that that company would have to take did it have no bond?

The principle is forcefully illustrated in the case of *Morris v. Windsor Trust Company*, 212 N. Y. 27; 106 N. E. 754, in an action for conversion where a pledgee, after payment of the pledge, sought to hold the pledged property on account of certain counter claims based upon other contracts, and where the right to setoff as against a trustee in bankruptcy proceedings was sought on a claim of the insolvent's estate against the holder of the pledge, and the appellate court of New York says:

> "I think the setoff is without sanction, either statutory or equitable. A wrongdoer who has misapplied the subject of a trust is not entitled, either under the Bankruptcy Act or under the rules of equitable setoff, to apply a credit that belongs to him in his own right in cancellation of his liability as a fiduciary."

The court directed attention to several cases which will be presently considered. This New York case should be further considered by the court as throwing much light upon the question of mutual debts and credits. The court says:

> "The law is thus settled that if the defendant held the pledge in trust for the bankrupt, it can not offset a debt that belongs to it in its own right. I think that, within the meaning of the rule which forbids the setoff of claims and liabilities held in inconsistent relations, a trust existed here. Within the meaning of that rule, a trust may exist, though it results by implica-

tion of law from the late relation between the parties."

That this obligation as well as the other assets of a failed national bank are trust funds in the hands of a receiver for the satisfaction of the debts of the bank has been determined in numerous cases, and, indeed, in the present case, the fact that it is a trust fund is admitted.

Again:

The right to setoff in the present case should be denied because the granting of such right would in effect divert a trust fund from its legitimate object.

The authorities heretofore directed to the attention of the court to some extent cover this subdivision. We have just directed the court's attention to the fact that it is agreed that the bond in question and upon which suit is brought, constitutes an asset of the bank and a trust fund for the benefit of all of the creditors.

In the case of *Sawyer v. Hoag*, 17 Wallace 610, this court had under consideration an effort on the part of a creditor of a corporation to offset a debt of the corporation to him as against an action by the assignee to recover on his subscription to the capital stock of the corporation. This court holds that the Bankruptcy Act was not intended to enlarge the doctrine of setoff, but that the former rules were ap-

plicable under the statute, and holds that the debt which the party owed for his stock was a trust fund devoted to the payment of all the creditors of the company on insolvency; that the right to setoff for an ordinary debt ceased; that the obligation on the capital stock in equity belonged equally to all the creditors.

In the case of *Cooke County National Bank v. United States*, 107 U. S. 445, this court had under consideration whether or not a section of the Revised Statutes giving the United States priority of payment of debts due to it would apply to demands against an insolvent national bank against the provisions of the law with reference to insolvent banks, which requires a ratable distribution of the estate to all the creditors. And notwithstanding the provision of the law first mentioned, the right on behalf of the United States was denied. The bank had on deposit at the time of its insolvency, certain postal funds and money order funds belonging to the United States. The Treasury Department at the time held United States bonds belonging to the bank to the amount of $150,000, as security for all moneys which might be deposited with the bank. These bonds were sold and applied to the payment of the amount then on deposit with the bank to the credit of the *Treasurer of the United States*. A part of the balance was applied on the postal funds referred to and a part on the money order funds referred to. In addition, there was on deposit in the Treasury of the United States $100,000 of bonds to secure its notes issued for circulation. When these bonds would be sold, there would

be a sufficient fund to redeem the notes, reimburse the United States in full for their advances, and leave a balance more than sufficient to pay the balance due on the postal funds and the money order funds. This court refers to the provisions of the National Banking Act with reference to ratable distribution of the assets to the creditors, and holds that the balance which would be in the hands of the United States after repayment to it of the advances for which the bonds were pledged could not be applied to the debt of the United States, and says:

> "It remains only to consider whether the United States have the right to claim the payment of this demand out of the surplus moneys remaining in the Treasury of the proceeds of the bonds deposited as security for the circulating notes of the bank. The surplus is sufficient to pay the demands of the United States in full. Can the United States set off their demand against these proceeds? We have no hesitation in answering this question in the negative. The bonds were received in trust as a pledge for the payment of the circulating notes. The statute so declares in express terms (citing statute). They were to be returned to the bank when the notes were paid, if not sold to reimburse the United States for moneys advanced to redeem the notes. The bank could have claimed their return at any time upon a surrender of the notes. The surplus constituted the assets of the bank, and part of the fund appropriated by the statute for its creditors. It was charged with this liability and was held subject to it after the purposes of the original trust were accomplished, although remaining in

the Treasury. It was then subject to a new trust. A trustee cannot set off against the funds held by them in that character, his individual demands against the grantor of a trust. Courts of equity and courts of law will not allow such an application of the funds so long as they are affected by any trust. It would open the door to all sorts of chicanery and fraud. The fund must be relieved from its trust character before it can be treated in any other character."

In the present matter, the funds in question, that is, the obligation of the plaintiff in error to the bank for the defalcation of Norwood, is a trust fund for all creditors. It belonged to the bank at the date of insolvency, and from that date is devoted to certain purposes, and under the authorities cited, should not be permitted to be diverted to other purposes.

Again, this court, in the case of *Western Tie & Timber Co. v. Brown*, 196 U. S. 502, had under consideration an attempt at setoff where a party running a store extended credit to the employes of a mining company, which was deducted from the pay of such employes and paid by the mining company to the store. The party running the store became insolvent and the mining company attempted to retain such funds to pay a debt to it as against the trustee in bankruptcy. The right of setoff was denied, the court saying:

"Now, as we have seen from the facts found, it must be that the agreement between Harrison and the tie company obligated the latter when it made the deduction from payrolls to remit to Harrison the amount of such deductions irrespec-

> tive of the account between iteslf and Harrison. It follows that as to such deductions the tie company stood toward Harrison in the relation of a trustee and therefore the case was not one of mutual credits and debts within the meaning of the setoff clause of the bankruptcy law. *Libby v. Hopkins*, 104 U. S. 303, and irrespective of the trust relation which the findings established, it is equally clear from general considerations that the right to setoff did not exist."

With equal clearness in the present matter, it was the duty and obligation of plaintiff in error, upon embezzlement by Norwood, to pay the amount of such embezzlements to the extent of its obligation to the bank as a trustee for such amounts. For being in the place of Norwood what was it but a trustee?

We also direct the court's special attention in this connection to the case cited by this court in the Western Tie & Timber Company case of *Libby v. Hopkins*, 104 U. S. 303, wherein A. T. Stewart & Company of New York, merchants, loaned Hopkins, a merchant, $100,000. Stewart & Company were the bankers of Hopkins with whom Hopkins kept two accounts, one of cash and the other merchandise. Remittances were sent to Stewart and credited to the cash account. The $100,000 note was secured. Hopkins directed certain remittances to be applied to that note, which was done, with the exception of two remittances aggregating $48,000. Hopkins became insolvent and Stewart & Company sought to hold the mortgage and apply the payments elsewhere. The right to do so was denied, and when the application of the payments were

not made in accordance with instructions, that Stewart could not hold such funds and set same off against its open account, but was liable to the assignee in bankruptcy therefor, and the court says:

> "The relation of banker and depositor did not arise and consequently there was no debt. When A sends money to B with directions to apply to a debt due from him to B, it cannot be construed as a deposit, even though B may be a banker. The reason is plain. The consent of A that it shall be considered a deposit and not a payment is necessary and is wanting."

In the present matter the consent of the bank that these obligations should be mutual, and that in the event it failed to pay the debt of the railway company, that the insurance company should not be required to pay to it the obligation as to Norwood is necessary and is wanting. Again the court says:

> "To authorize a setoff, there must be mutual credits or mutual debts. The remitting of certain money assets of Hopkins to the plaintiffs to be applied by them according to his instructions, did not make them his debtors but his trustees, so that there were in the case no mutual credits or debts."

The instructions of the bank to the insurance company, if the expression may be permitted, at the time the policy was taken out, was simply that if Norwood embezzled the funds of the bank, the insurance company would repay those funds. That was the simple contract of the insurance company, in which contracts others have now become interested by reason of in-

solvency. Had there been no insolvency, unquestionably there could be no offset. There was no debt except by reason of insolvency, and certainly parties should not be permitted to get a higher right by insolvency than they had prior to insolvency. Attention is also directed to the fact that in the Libby case the Supreme Court indicates that *mutual credits* mean only such as "*must in their nature, terminate in debts.*" There was no debt incurred by any of the obligations involved; there was no obligation incurred which should necessarily result in debt, hence there was no mutual credit.

Again, this court, in the case of *Hanover National Bank v. Suddath*, 215 U. S. 110, held that where a bank had sent certain securities to another bank for the purpose of procuring a loan, which was denied, and the bank to which they were sent endeavored to apply such securities to other indebtedness, that this could not be done, and that the securities sent for a specific purpose were a trust fund and could not be so applied and belonged to the receiver. In a companion case by the same bank reported at page 122 of the same volume, the court indicates that the circumstances of the transaction were insufficient to raise a presumption of agreement for an offset which would be available as against the general creditors. If, in the two cases mentioned, there was insufficient evidence to show a presumption of agreement for a set-off, as decided by the Supreme Court in the case of *Scott v. Armstrong*, 146 U. S. 499, there were certainly, under the facts of the present controversy, no

circumstances which would raise any presumption of agreement for a setoff for the simple reason that the obligations were not in the same right and were intended to accomplish certain specific things for different parties, with evidently no thought of offset.

In this connection also, attention is directed to the case of *Continental & Commercial Trust & Savings Bank v. Chicago Title & Trust Company*, 199 Federal 704 (June 24, 1912, Cir. Ct. Apps., 7th Circuit), where deposits were made to accomplish certain objects and the bank sought to offset the same. The right was denied.

Also, it is well to bear in mind the rule stated by Story in Equity Jurisprudence, 10th Ed. Sec. 1436:

> "But the mere existence of cross demands will not be sufficient to justify a setoff in equity. Indeed a setoff is ordinarily allowed in equity only when the party seeking the benefit of it can show some equitable grounds for being protected against his adversary's demand—the mere existence of cross demands is not sufficient."

How rigidly the rule with reference to the right of setoff must exist at and previous to the time of insolvency is illustrated by the case of *Yardley v. Philler*, 167 U. S. 344, where banks in the City of Philadelphia had organized a clearing house association. The rules required deposit of securities by the member banks as collateral for their daily settlements, and also provided for the time and the mode of settlement. The Keystone Bank, prior to its insolvency, complied with the

rule of deposit, but being indebted to the clearing house for large amounts, the securities were surrendered and were redeposited as security for the payment of clearing house certificates. In the clearing of March 19, 1891, the Keystone Bank was a debtor to the clearing of over $75,000, which it paid in cash or its equivalent and gave a due bill for a small excess. In another exchange on that day the Keystone Bank owed a balance of over $23,000, which it settled by giving its due bill. In clearance on the morning of March 20th, the Keystone Bank was left debtor in the clearing of over $47,000. The demands of the Keystone Bank against other banks were taken by the agents of said banks, and charges against the Keystone Bank were not taken away by it, but were turned over to the manager of the clearing house until the balance due the clearing house was paid by the Keystone Bank. Before that hour arrived, the Keystone Bank was closed and subsequently placed in the hands of a receiver. On its failure to pay the balance owing in the clearing, the banks redeemed the demands of the Keystone Bank, among which were due bills of the Keystone Bank of over $40,000. After paying off obligations from the funds returned to him, the manager of the clearing house association attempted to appropriate a balance of over $28,000 on the loan certificate account of the Keystone Bank to the association, and as to that item the Supreme Court held, as the manager of the association was in possession of funds as a fiduciary agent of the Keystone Bank, the attempt to apply to indebtedness was obviously a preference within the meaning of the National Banking Act. The

Supreme Court, at page 354, states first, the claim of the receiver of the Keystone Bank and then states the claim of the clearing house association as follows:

> "On the other hand, the claim of the clearing house association is that it owes nothing and that by default of the Keystone Bank the clearing house became entitled to appropriate the balance of the credit due the Keystone Bank in the clearing to debts due to the clearing house, although such debts were not of a nature to have authorized them to be charged against the clearing if the failure had not taken place; that is, the clearing house also contends that the effect of the failure was to give it rights against the Keystone Bank which it would not have had if the failure had not taken place.
>
> "The claims of both parties, therefore, when analyzed, amount to the assertion as a proposition of law that they both have greater rights in consequence of the insolvency than they would have had if the insolvency had not taken place. The self-evident error of this proposition points to the unsoundness of the claims of both parties to the controversy."

This demonstrates conclusively that a party can have no higher rights by reason of insolvency than he had without insolvency, so assuming in the present matter that there was no insolvency and hence no default to pay the railway company, what right of offset would plaintiff in error have? There can only be one answer and that is, None, because plaintiff in error had no credit in the bank growing out of the Norwood bond or otherwise, which would entitle it to an offset.

Can it acquire a greater right through insolvency than it would have had without insolvency? This court says, No.

Again, in the same case, and discussing the right of setoff, and referring to a case relied upon by plaintiff in error, the court says:

> "But obviously the right to setoff as recognized in *Scott v. Armstrong*, 146 U. S. 499, is to be governed by the state of things existing at the moment of insolvency and not by conditions thereafter created. The case under this aspect is directly controlled by *Nashville Security Bank v. Butler*, 129 U. S. 223, and indeed is governed by the general principle announced in *Davis v. Elmira Savings Bank*, 161 U. S. 275."

It occurs to us in view of the fact that a party can have no higher rights by reason of insolvency than he had without insolvency, this must necessarily confine plaintiff in error to his theory that the mutual obligations out of which the party's right of offset arose, grew out of the defalcations of Norwood. We have heretofore answered this fallacy.

The case of *Davis v. Elmira Savings Bank*, 161 U. S. 275, was an attempt on the part of the parties under the insolvency laws of New York to give preference in a national bank to savings deposits, which effort was denied, and the Supreme Court of the United States held the law of the United States was paramount so far as national banks are concerned. And holds plainly that the object of the national bank system was to secure just and equal distribution of assets

among all unsecured creditors, and to prevent banks from creating preferences. The court quotes from various cases, and especially from the case of *Scott v. Armstrong*, and indicates very plainly that the right of offset does not exist in cases of this character, for it is made plain that right is based upon the striking of a balance in mutual accounts at the time of insolvency, and indicates that where the result of a setoff will be to prefer one creditor over another, the transaction must necessarily have been held to have been entered into with the intention of producing that result.

REVIEW OF CASES RELIED UPON BY PLAINTIFF IN ERROR

Probably the most important case urged and relied upon by plaintiff in error is the case of *Scott v. Armstrong*, 146 U. S., page 499. We do not think the case is in point from plaintiff's in error standpoint, but think the reasoning of this court in that case beyond reasonable controversy sustains the position that we take, and hence the judgment by the court below in this cause.

The Scott case arose by reason of an action by Armstrong as receiver of the Fidelity National Bank of Cincinnati, Ohio, to recover from Scott and the Farmers & Mechanics State Bank on a note executed by Scott and endorsed by the Farmers & Mechanics State Bank. Scott was the cashier of the Farmers & Mechanics State Bank, and for the accommodation of

that bank as well as the Fidelity National Bank, executed a note to the Fidelity Bank endorsed by the Farmers & Mechanics Bank, the proceeds of which were placed to the credit of the latter bank with the Fidelity Bank, with the understanding that it was to remain there for the purpose of taking up the note executed by Scott and endorsed by the Mechanics Bank, a large part of which was to the credit of the Mechanics Bank at the date of the failure of the Fidelity Bank, which note, however, was not due at the date of the failure of the Fidelity Bank. Clearly there was mutuality, and clearly there was an agreement for offset. But plaintiff in error, by some expressions which he seeks to interpret in their favor, construed the decision as favorable to their position.

The court, of course, recognizes the general principle that the receiver can have no higher rights than the bank, and that the receiver took the assets of the insolvent bank "as a mere trustee for creditors and not for value, and without notice, and in the absence of statute to the contrary, subject to all claims and defenses that might have been interposed as against the insolvent corporation." The case while recognizing that offset ordinarily is a provision of the statute, but from an early date courts of equity granted relief independently of statutes, as well as in aid of statutes, and gives the grounds upon which courts of equity have usually exercised this jurisdiction, and likewise recognizes the principle that such offsets are usually matters of contract, and that there is a presumption that

the parties intended to meet the obligations with mutual credits and says:

> "Indeed, natural justice would seem to require that where the transaction is such as to raise the presumption of an agreement for a setoff, it should be held that the equity that this should be done is superior to any subsequent equity not arising out of a purchase for value without notice."

It may be remarked that there is no evidence in the record in this case of any agreement for a setoff, but on the contrary the clear presumption is that there was no agreement of that character in the light of what was actually done in purchasing by the insolvent bank of the indemnity bonds in question.

In the Scott case again the Supreme Court says:

> "In the case at bar the credits between the banks were reciprocal and were parts of the same transaction in which each gave credit to the other on the faith of the simultaneous credit and the principle applicable to mutual credits applied. It was, therefore, the balance upon an adjustment of the accounts which was the debt and the Farmers Bank had the right as against the receiver of the Fidelity Bank, although the note matured after the suspension of that bank to setoff the balance upon its deposit account, unless the provisions of the national banking law were to the contrary."

It may again be remarked in passing that under tests named there was no mutuality of credit in the transactions in controversy in this case, and no ground

for the application of the principles of mutual credits. There was nothing in the bank to the credit of plaintiff in error. The bond belonged to the railway. There was nothing there except an obligation of the plaintiff in error to protect the bank against the defalcations of Norwood, its president. The insurance company, plaintiff in error, had no credits there for the purpose of meeting such obligations, and it had no claims against the bank until it paid the obligation to the railway company, which occurred long after the insolvency. The bank held no obligations against the railway company. There was no mutual right as between the bank and the railway Company as to offset, because the railway company owed the bank nothing. The plaintiff in error now seeks to place itself in the place of the railway company and secure rights the railway company never had.

And in the case we are reviewing this court says with reference to the statutes regulating the disposition of the funds of insolvent banks:

> "The requirements as to ratable dividends is to take them from what belongs to the bank and that which at the time of the insolvency belongs of right to the debtor does not belong to the bank."

What did plaintiff in error have in the bank at the time that belonged to it? There was no credit there, and there was no obligation there in its favor, and in construing the rights of the plaintiff in error it is well to keep in mind the principle that its contracts as a paid surety or guarantor will be construed most rig-

idly against it. *Pauly v. American Surety Co.*, 170 U. S. 160.

Clearly the insurance company acquired the claim of the railway company after insolvency. It had no such right before insolvency, and this court says in the Armstrong case:

> "The state of case where the claim sought to be offset is acquired after the act of insolvency is far otherwise, for the rights of the parties become fixed as of that time, and to sustain such a transfer, would defeat the object of these provisions."

But if there is any doubt left as to whether or not the decision in the Scott case is at all favorable to plaintiff's in error position that doubt is entirely removed by what the Supreme Court itself said of the decision in the Scott case in the case of *Davis v. Elmira Savings Bank*, 161 U. S. 275, as follows:

> "The difference between Scott v. Armstrong and the present case is this: There this court was called on to determine whether a claim which had been extinguished, by operation of law, prior to the insolvency was still due after the insolvency, but here the question is whether a claim existing at the time of the insolvency and up to that date unsecured, shall, by the operation of an insolvent statute, be converted after the insolvency into a preferred claim to be paid by preference over all other creditors."

Prairie State Bank v. U. S., 164 U. S. 227.

We do not think that there will be any difficulty in distinguishing this case from the one at bar. We mention some of the distinguishing features. There was no Federal Insolvency Law involved; there was no law involving the insolvency of national banks; there were no rights of others with equal or better standing.

In the Prairie case, subrogation arose out of the original contract and not out of another contract. Again the obligee was the Government and subrogation was to funds held by the Government after the Government's contract had been fully complied with, and not subrogation to funds and rights with which the Government had nothing to do. When the surety complied with the contract, it simply owned the funds in the hands of the Government which belonged to its principal, Sunberg.

Here, however, we have the surety seeking to apply the funds of another distinct and unrelated contract, because of its compliance with its contract as to the railway bond.

There is one feature of this case, however, which we desire to direct specially to the attention of the court. It will be recalled that on both of the bonds involved in this controversy, there were clauses which allowed the surety company, at its own pleasure, by giving notice, to absolve itself from liability. For considerations which were evidently adequate to it, it preferred to be bound. We submit that the follow-

ing adopted language of this Honorable Court in the Prairie case becomes very pertinent to that situation:

> "The doctrine of subrogation is a pure unmixed equity having its foundation in the principles of natural justice, and from its very nature, never could have been intended for the relief of those who were in any condition in which they were at liberty to elect whether they would or would not be bound; and as far as I have been able to learn its history, it never has been so applied. If one with the perfect knowledge of the facts will part with his money, or bind himself by his contract in a sufficient consideration, any rule of law which would restore him his money or absolve him from his contract, would subvert the rules of social order."

It seems to us that this expression is specially pertinent to plaintiff in error. It had the power to elect whether it would or would not be bound. It preferred to remain bound, evidently for the considerations passing to it. Then when disaster comes, though it had bound itself to pay both of these bonds "in a sufficient consideration," it now seeks to absolve itself from one of the contracts.

We deem it important also in connection with that case to direct the court's attention to what is said by the court as to the question that is to be determined, which is simply, "Which of the two contestants possesses a superior right to the fund?" We think an analysis of the facts and of the rights of the respective parties, and of the rights of a large

number of creditors who were not protected by any bond, clearly discloses a superior right to the fund in the Receiver rather than plaintiff in error, when the latter would be depriving others equally meritorious of their rights, and at the same time absolving itself from performing its plain obligation under the terms of the contracts, and thereby enabled it in a court of equity to discharge obligations which it had assumed, aggregating \$48,000.00, by the payment of \$25,000.00, to the injury and damage of others.

What has been said with reference to the Prairie case, we think applies with equal force to the following cases cited by plaintiff in error:

> *Henningsen v. U. S. Fidelity & Guaranty Co.*, 208 U. S. 403.
>
> *Hardaway v. National Surety Co.*, 211 U. S. 550.
>
> *Cox v. New England Equitable Ins. Co.*, 247 Fed. 955.
>
> *Wasco County v. New England Equitable Ins. Co.*, 172 Pac. 126.
>
> *North Chicago Rolling Mill Co. v. Oregon Steel Co.*, 152 U. S. 594.

We have no doubt that the quotation from the last above mentioned case furnishes much stronger argument on behalf of the position taken by defendant in error than on that taken by plaintiff in error. It seems to us that it is almost conclusive from the standpoint of pure right that to allow the setoff in this case would have the effect of working "wrong

and injustice" rather than preventing it. We do not doubt the power of a court of equity to prevent wrong and injustice by allowing cross demand and counter claims, but we assert that a court of equity will not allow it when the effect is to wrong and injure others. From these authorities, as well as others, it is obvious that a court of equity has the power and should yield it, of looking situations of this kind squarely in the face, and following that course which prevents wrong and injustice, rather than that which would perpetuate it.

We shall further assume, in the light of authorities already directed to the attention of the court, that the statutes of the State of Texas pertaining to counter claims and offsets have nothing to do with this controversy, because as to this controversy, the laws of the United States have taken the field and constitute the sole guide to determine the rights of the parties. This is a national bank being liquidated as an insolvent institution under authority of an Act of Congress. We will state, however, that the statutes of Texas are practically the same as those adopted in all other states regarding counter claims and offsets, and as construed by the courts of this state, were it important to enter that field, would give to the plaintiff in error no aid or comfort.

We are aware of the fact that a good many courts have held that the mere fact that a surety is a compensated surety, makes no distinction in the rights of that surety, but it does not broaden those rights, but if anything, it causes a court of equity to look

at the entire situation more closely and to construe more strongly against such a surety its contracts than it otherwise would. Moreover this is an additional circumstance for a court of equity to take into consideration in determining whether or not such a surety should have the right of subrogation, where the effect would be to injure the rights of others to create a preference and to avoid a compliance with the terms of its plain contract. For as to the banker's bond, it must be kept in mind that the surety company is a mere insurer, and the question is: To whom do the funds of the insurance belong when the policy has become due and was payable to the bank and not the railway?

There is another case cited by plaintiff in error which will be reviewed under the following heading:

CASE CLAIMED IN POINT BY PLAINTIFF IN ERROR

Our position is that principles already announced by this Honorable Court in cases to which attention has heretofore been directed, settle the point involved against plaintiff in error.

However, the one case which indicates a holding favorable to the position of plaintiff in error, which we have been able to find, is that cited by plaintiff in error, and is—

> *Fidelity & Deposit Co. v. Duke*, 293 Fed. 661 (Ninth Circuit).

This case was decided by the Circuit Court of Appeals of the Ninth Circuit, December 3, 1923, about

the time of the submission of the present controversy in the Circuit Court of Appeals for the Fifth Circuit.

The case involved a similar state of facts to that in controversy, and the Honorable Circuit Court of Appeals for the Ninth Circuit, in a decision by Judge Bourquin, reversed the case on the first point by reason of insufficiency of evidence in failing to show that the bank was out anything by reason of the acts of its cashier.

The court then proceeds to discuss other points involved in the case "for enlightenment therein." It is therefore obvious that the points discussed were not necessary to the decision of the case, and might therefore be properly treated as obiter.

Again, the case did not involve insolvency under the National Banking Act, and it appeared that both the bank and the cashier were insolvent. In the present case, the bank is insolvent, but there is no showing as to the insolvency of Norwood, the president, unless it is to be inferred from the fact that he embezzled funds of the bank and is a defaulter. The bond was also a statutory bond.

The court seems to work out its conclusions in that case to some extent on a construction of the state statute governing that case, because the statute does not stiuplate expressly for a bond for the benefit of third parties.

In an effort to distinguish the case of *Equitable Co. v. McMillan*, 234 U. S. 459, the court seems to indicate that no suit could be brought on the bonds of

third parties who were depositors, and hence such depositors would have no interest in the bonds. It seems to us such a holding is hardly equitable, for a court of equity usually finds the means to work out a situation of that kind in favor of the party to whom the fund justly belongs, and is not confined to strict rules of law in doing so, for at least a court of equity could say to a party asserting subrogation and the right to take funds belonging to others, that it will leave such a party where it finds him, and not grant him the right of subrogation where the effect would be to deprive parties to whom the fund justly belongs of their rights, simply because such parties would have no right of action on the particular obligation.

The court does recognize the principle that the surety cannot set off debts when they were not mutual and not in the same right.

The court then proceeds to recognize the principle that a receiver stands in the bank's shoes and is subject to all the defenses and rights against the bank, and then the court announces a peculiar principle in favor of one to whom it is going to extend an equity, in the following language:

> "Further adverting to familiar principles, defendant as surety, stands in the cashier's shoes in no worse position, and entitled to like rights and remedies. Unquestionably, had the bank or supervisor sued the cashier upon this cause, he could set off any debt due him from the bank. Likewise can his surety, this defendant."

The effect of this holding, if we grasp it, is to say that a bank cashier may embezzle and misapply the funds of the bank, or may take them *vi et armis* from its vaults, and when caught with them, he could merely say to the court or other, requiring him to deliver them, "I have a claim against that bank which I want to collect and to offset against my theft of funds." We do not think he ought to have a very good standing in a court of equity. We think probably a court of equity would say to him, "Restore the stolen property before we will listen to you." That being true, why should it not say the same thing to the surety company, who, as the court [illegible] case referred to, says: "stands in the cashier's shoes."

But again, if this principle is sound, why does it not permit one person, when his neighbor owes him money, to go and take that neighbor's cow, and say that he will hold the cow until his debt is paid. We believe this character of principle well established would lead us back to where our civilization started when "Might was right."

However, if our reasoning as to the correctness of this decision is not sound and it is not error on other principles, we desire to quote fully what was said about it in the case of *Fidelity & Deposit Company of Maryland v. Robinson*, by Judge Dietrich in an opinion handed down July 5, 1924, and which is not reported, but which is found at page 64 of the record in that case now on file in the Circuit Court of Appeals for the Ninth Circuit, as follows:

"The plaintiff, as reeciver for a defunct national bank, sues the defendant, a surety company, upon its bond given the bank for the faithful discharge of his duties by one of its employed officers, and defendant pleads, as set-offs, its liabilities upon bonds given by it to depositors, at the instance of the bank, to insure payment of their deposits. Plaintiff challenges the sufficiency of the pleaded set-offs to constitute a defense, and the precise question is whether or not, upon defalcation of a national bank officer and failure of the bank, a surety company can set off its liability, upon bonds given at the request of the bank to depositors, against its liability upon its fidelity bond given to the bank."

"In considering the question, regard must be had for the letter and spirit of the federal statutes for bidding preferences and requiring ratable distribution of the insolvent bank's assets to all of its creditors alike. R. S. U. S. sec's. 5234, 5236, 5242 (Comp. Stats. Sec's. 9821, 9823, 9834). Owing to indorsed rediscounts with liberal collateral, secret guarantees, application of the trust fund theory, legal preferences, and divers other conditions, it has become distressingly common for the large apparent assets of insolvent banks to turn out to be Apples of Sodom for the ordinary, unsophisticated depositor. Legal rights, though preferential, we of course must recognize, but the defendant here is not standing upon legal rights; it must invoke equitable considerations. Undoubtedly, under certain conditions, equitable set-offs, may be allowed without violating the statutes above referred to (Scott vs. Armstrong, 146 U. S. 499); but the allowance must rest upon a superior

equity in the claimant. As was said by the court in the Scott-Armstrong case: 'Courts of equity frequently deviate from the strict rule of mutuality (as defined by the text writers) when the justice of the particular case requires it, and the ordinary rule is that where the mutual obligations have grown out of the same transaction, insolvency on the one hand justifies the set-off of the debt due on the other. Blount v. Windley, 95 U. S. 173, 177.' And again: 'Indeed, natural justice would seem to require that where the transaction is such as to raise the presumption of an agreement for a set-off, it should be held that the equity that this should be done, is superior to any subsequent equity not arising out of a purchase for value without notice.' And in the later case of Yardley v. Philler, 167 U. S. 344, it was said: 'But, obviously, the right to set-off as recognized in Scott v. Armstrong, 146 U. S. 499 (36:1059), is to be governed by the state of things existing at the moment of insolvency, and not by conditions thereafter created. The case under this aspect is directly controlled by National Security Bank v. Butler, 129 U. S. 223 (32: 682), and, indeed, is governed by the general principle announced in Davis v. Elmira Sav. Bank, 161 U. S. 275 (40: 700).' It will thus be seen that the application of the principle is somewhat strictly circumscribed.

"Such rights as defendant may have to recover from the bank upon its implied obligation to make good to its losses incurred upon the depositors' bonds, and such rights as it acquired by subrogation, did not exist at the time title to the bank's assets passed to the receiver, but accrued only when defendant made payment upon

the bonds. Upon one of these bonds it has paid nothing, and upon others payment was not made until some time after the bank closed its doors. The doctrine of relation is assigned for the promotion of justice, and cannot be invoked to work out an inequitable result. What then are the equities of the defendant as compared with those of the general depositors, whose interests will of course be substantially affected by the allowance of the counterclaim? For the sake of brevity, let us suppose a simple illustrative case: A, the cashier of a bank, is bonded for $50,000. X and Y are general depositors. A embezzles $50,000, and the bank fails (The one condition often follows the other). Defendant makes good to the receiver the $50,000 embezzled, and it is distributed to X and Y. A step further: After the cashier's bond is given, the surety company executes another bond for $50,000 to secure B's deposit; then the defalcation of the cashier and the insolvency of the bank. The surety company pays the latter bond, and, under defendant's offset theory, thus, in effect, wipes out its obligation upon the first. In other words, the protection to X and Y, supposed to be vouchsafed in the fidelity bond, is potentially lost the moment the surety executes the bond to B. The surety company is a surety for hire, and receives full compensation for each of the two bonds, but, under the defendant's contention, in no contingency can it be held really liable on both; Unless the bank fails, or the bonded officer is unfaithful, there is of course no loss, and no liability. If there is defalcation without failure of the bank, there is liability only on the fidelity bond. If failure and no defalcation. there is liability only upon the bond to the special depositor. If both

defalcation and failure, the discharge of the one obligation in effect ipso facto discharges the other. Another angle: If the bank procures the fidelity bond from one surety company, and the depositor's bond from another, there is full liability upon both in case of embezzlement and insolvency; but if, paying the same premiums, it procures both bonds from a single surety company, under the doctrine of set-off contended for, it is without effective remedy upon the fidelity bond.

"Surely the transaction is not such 'as to raise the presumption of an agreement for a set-off,' nor are defendants' equities superior to those of depositors and other creditors. Upon paying the bonded depositors' claims it became subrogated to their claims against the bank, and should be and is being recognized as having all of the rights of such depositors to share in the assets of the estate. To accord them more would be in effect to grant a preference.

"The precise question has recently been decided adversely to defendant by the Circuit Court of Appeals of the Fifth Circuit in U. S. F. & G. Co. v. Wooldridge (295 Fed. 847), which is the the only parallel case brought to my attention. Such hesitancy as I have is due to a decision of our own Circuit Court of Appeals in Fidelity & Deposit Company v. Duke, (293 Fed. 661.) With other defenses, the surety company there set up a counterclaim quite analogous to the one here under consideration, and in the lower court it was rejected. The insolvent bank was a state institution, and hence not subject to the federal statutes which we have here to consider. The appellate court reversed the judgment below, and ordered a new trial, upon a ground, however,

having no relation to the counterclaim. For the 'enlightenment' of the trial court it then proceeded to discuss certain other features, including the counterclaim. I desire, of course, to conform to the views of the appellate court, but because of the fact that the national banking laws were not involved, and the question of whether the discussion of the counterclaim is to be deemed a part of the decision or orbiter only, I am not at all sure that I can with propriety disregard my own independent judgment, supported as it is by the express decision on the identical question in an appellate court of like dignity, in another territorial jurisdiction. However, under the general doctrine that a doubtful defense ought not to be disposed of by striking out the pleading, I have decided to deny the plaintiff's motion to strike, and his demurrer, without prejudice, to the end that the record for final decision here and for review above may exhibit all the facts, and full justice may be done without unnecessary delay. Particularly appropriate does this course appear to be if, as I understand the rule of the Supreme Court, such an issue turns upon the superior equities, and the equities are to be determined in the light of the particular facts of each case."

A copy of this record has been furnished us, and we have also requested a certified copy of the opinion of Judge Dietrich, but if on submission the latter is not available, we will leave with the Clerk a copy of the record, and also a certified copy of the opinion, if same is received. The record in that case further shows that on hearing set-offs were denied.

We view the reasoning of the Honorable Circuit Court of Appeals of the Ninth Circuit in the Duke case as largely *dicta* and hence are reminded of what Chief Justice Marshall said pertaining to that in *Cohen v. Virginia*, 6 Wheat. 399.

We will proceed to cite to the court some additional cases which we contend decide favorably to our position the exact point involved.

CASES CLAIMED DECISIVE BY DEFENDANT IN ERROR

United States Fidelity & Guaranty Company v. Maxwell, 237 S. W. 708.

Practically the exact question presented in this proceeding was before the Supreme Court of Arkansas February 20, 1922, in the above case, where this same plaintiff in error had issued an honesty bond similar to that issued in this case to the National Bank of Cleburne, to the Bank of Blytheville. The parties against whose wrongful acts it was intended to apply misappropriated the funds of the bank in that case as did Norwood in this case. In that case, appellant company had also issued a guaranty bond to the Missouri State Life Insurance Company to protect it on deposits made with the Bank of Blytheville, and when failure occurred, appellant company sought to offset against its honesty bond the deposit in favor of the Missouri State Life Insurance Company after having paid that deposit and taken an assignment thereof, as was done in the present case. The court says:

"The law is well settled and where there is a statute prohibiting preferences in claims against insolvent corporations, claims acquired after insolvency or after the appointment of a receiver cannot be set off against debts owing to the corporation in the hands of the receiver for collection, for if the law were otherwise, the statute against preferences could be defeated by the purchase of outstanding claims and having them allowed in full as a setoff. The right of setoff exists only to the extent of the concurrence of the two claims, and in case of insolvency proceedings under a statute prohibiting preferences the concurrence of claims must have existed before the insolvency occurred and the proceedings were instituted. 34 Cyc. 194-198; Miller v. Audenreid, 67 N. J. Eq. 252, 57 Atl. 1076; Smith v. Mosby, 9 Heisk. (Tenn.) 501. Such is the effect of our decision in the case of Funk v. Young, supra. In that case a depositor in an insolvent bank sought to set off his claim against his own liability to the bank on a promissory note, and we held that he was entitled to do so on the ground that his right to setoff existed at the time that the affairs of the bank passed into the hands of the receiver, and that the right was still intact. The converse of that doctrine is that if his right of setoff did not exist at the time the receiver took charge he could not have acquired the right.

"The question then arises whether appellant's claim against the bank arose prior to the insolvency of the bank or the taking over of its affairs by the commissioner. Our conclusion is that the claim in favor of appellant did not arise until after the bank commissioner took possession of the insolvent bank and that the claim is not avail-

able as a setoff against appellant's liability under the bond.

"In the transaction between appellant and the Missouri State Life Insurance Company there was no privity of contract between appellant and the Bank of Blytheville. Appellant had no claim against the Bank of Blytheville and never acquired any claim until it made good its contract of indemnity after the bank commissioner took possession of the affairs of the bank. There was no concurrence between the respective claims of the bank commissioner, as receiver, under the bond sued on and the claim which appellant acquired by complying with its contract of indemnity with the Missouri State Life Insurance Company. Appellant was not a surety for the bank, but was a mere guarantor or insurer of the Missouri State Life Insurance Company against loss. Appellant took an assignment of the claim when it paid to the Missouri State Life Insurance Company the amount of the deposit, but if we treat appellant as being entitled to the right of subrogation without a formal assignment of the debt, it is in no better attitude to claim the right of set-off, for, as we have already stated, there was no privity of contract between the bank and appellant prior to such payment, and in the absence of a formal assignment of the debt the payment of the amount was tantamount only to as equitable assignment. The right of subrogation carries with it all the securities held by the original claimant, but this does not extend to the right to set off a claim which the party entitled to subrogation did not own prior to that time.

"If appellant be allowed to set off this claim, the effect would be to give it a preference on a

claim against the bank acquired subsequent to the time that the bank became insolvent, and passed into the hands of the receiver."

The next case which we think decides the point is *Lion Bonding & Surety Co. v. Austin*, 208 S. W. 542 (C. C. A. Texas on Jan. 2, 1919). Briefly, the facts were, the Peoples State Bank & Trust Company was doing a general business at Longview with G. N. Campbell as its cashier. Campbell executed a fidelity bond with the Lion Bonding & Surety Company as surety. The bank became insolvent by reason of the misappropriation of a large amount of funds by the cashier and another.

The action was brought by Austin as the Commissioner of Insurance and Banking of the State of Texas against Campbell and the bonding and surety company to recover the amount of the fidelity bond.

The bonding and surety company plead in offset the fact that the defunct bank was the depositary of Gregg County, and that the bonding and surety company became the surety for the bank to that county; that the county filed a suit against the bonding company to cover deposits. The bank was subsequently dismissed and the suit was prosecuted to judgment against the bonding and surety company, the judgment providing that the bonding and surety company should be subrogated to the rights of Gregg County. The bonding and surety company satisfied the judgment and pleads that payment as a basis for a legal and equitable counter claim to offset the demand sued

on. The offset was refused by the court below, and that ruling assigned as error, but same was affirmed.

The court held that under the authority of the laws of Texas, the county had no superior rights to the funds of the bank; that the mere fact that the bonding company was a bank's surety, did not in law make it a creditor of the bank with which the county had deposited funds, the court indicating that it was evidently the policy of the Legislature of Texas that all claims against a bank should share according to the same percentage in the distribution of its assets along the lines of cases which have been heretofore directed to the attention of this court as to Federal Laws and then says:

> "The appellant never in fact acquired any claim against the insolvent bank until it satisfied the debt recovered against it by Gregg County. It appears that this was done after the affairs of the bank had passed into the hands of the Commissioner of Insurance and Banking and were being administered. The mere fact that it was the bank's surety did not in law make it the bank's creditor. It could not become such till it had paid something for which it might claim reimbursement in the distribution of the bank's assets. By merely paying the debt under compulsion for which it was a surety, the appellant's attitude is not materially different from what it would have been had it voluntarily purchased the claim at that stage in the administration of the bank's affairs. It seems to be a well-settled rule that one who is sued by a trustee charged with the administration of an insolvent estate will not be permitted to offset the demand sued on with a

claim against the insolvent acquired after the admniistration had begun. Guthrie v. Guthrie, 17 Tex. 543; Northcraft v. Oliver, 74 Tex. 162, 11 S. W. 1121. While that rule has its exceptions, the facts of this case do not bring it within the spirit of any that have been announced. Smalley v. Trammel's Adm'r., 11 Tex. 10; Dickenson v. McDermott's Ex'rs., 13 Tex. 248. To permit the appellant in this instance to offset against the demand here sued on with the claim acquired from Gregg County, would enable it to secure an illegal advantage over other creditors in the distribution of the assets of the insolvent bank. What one cannot do directly the law will not permit to be done indirectly. Equity is no respector of persons; one creditor cannot in its name invoke a rule that would operate as an injustice toward another creditor entitled to the same consideration."

Again:

Setoff should be denied not only because it was not contemplated by the parties to the banker's bond, but because said bond itself repels the idea of subrogation and setoff under the circumstances of this case, if indeed, it does not by express provision exclude that idea.

The principal terms of the banker's blanket bond have been heretofore mentioned, either in brief of plaintiff in error or in this brief. The bond itself is found at pages 11 to 14 of the record. We direct special attention to the two following provisions:

7. "In case of recovery, whether made by the insured or the underwriter, on account of any loss hereunder, from any source other than insurance or suretyship, the net amount of such recovery, less the actual cost and expenses of making same, shall be applied to reimburse the insured in full for such loss, and the excess, if any, shall be paid to the underwriters; and the insured shall execute all necessary papers to secure to the underwriter the rights herein provided for."

10. "If the insured shall hold, as indemnity against any loss covered hereunder, any valid enforceable security, other than the fidelity suretyship, if any, for which credit has been given in accordance with the preceding section, the underwriter shall be liable hereunder only for such proportion of such loss as the amount of this bond bears to the aggregate amount of this bond, and such other security."

We submit by the provisions of the contract copied, that the circumstances under which the surety or insurer was to have recourse on any other funds to recoup its loss are covered by the terms of the contract, for there it is clearly contemplated (which would be simply justice as between the parties), that the underwriter should receive no compensation from any sums realized by the insured until the insured had been fully compensated for all loss by reason of the defalcation of any of its officers.

Not only is this true, but provision 10 copied above additionally protects the underwriter as to any other securities held by the insured to protect itself.

We submit that a reasonable construction of the terms of the contract, and especially construed against the insurer, as it should be construed, will demonstrate that all rights the underwriter was to have in any securities, and all rights of subrogation, were fully covered by the provisions referred to and that no others should exist.

CONCLUSION

From the foregoing facts and authorities applicable, it seems to us clear that the offset in this case should be denied, and that the court below and the Circuit Court of Appeals rendered correct decisions.

It seems to us obvious from the circumstances outlined that offset was not in contemplation of the parties at the time the contracts were entered into. On the contrary, that the circumstances surrounding the transaction, and purposes of contracts repel any idea that such offset was either expressly or impliedly contemplated. It seems further obvious that at and prior to insolvency, there was no right of offset in the railway company, or plaintiff in error, on the bond sued on, and that such right cannot be acquired subsequently either by assignment or by subrogation; that there was no mutuality, and asserted right did not arise from same transactions; that to permit an offset under the circumstances would deny to general creditors their just rights; that to permit it, would through equitable subrogation give to plaintiff in error rights never possessed by the railway to whose rights it asserts it is subrogated; that to allow it, would

have the effect of diverting a trust fund from its beneficent purposes and to grant a preference in violation of the express terms of law; that plaintiff in error, standing for a defaulter, must replace the funds before it has any rights; and furthermore, if allowed would enable plaintiff in error to pay off and discharge its solemn obligations for a total amount of more than $48,000, all of which was clearly due and payable, by the payment of only $25,000, and thereby defeat the very purpose of one of the contracts.

We therefore earnestly submit that the alleged right should be denied and the trust fund held intact for the purposes for which it was intended, and the judgments below in all things affirmed.

It will be noted plaintiff in error does not complain of the judgment because it does not allow subrogation to such dividends as the railway would have been entitled to as an unsecured creditor. To avoid confusion, we deem it not improper to say that the plaintiff's in error rights in that regard are protected by agreement.

Respectfully submitted,

Ellis Douthit

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(20)

No. 352

In the

Supreme Court of the United States

October Term, 1924

UNITED STATES FIDELITY & GUARANTY COMPANY,
Plaintiff in Error,

vs.

A. P. WOOLDRIDGE, RECEIVER NATIONAL BANK OF CLEBURNE, *Defendant in Error.*

Error to the United States Circuit Court of Appeals for the Fifth Circuit

REPLY TO BRIEF OF AMICUS CURIAE

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REPLY TO BRIEF OF AMICUS CURIAE

We deem it advisable to make a short reply to the argument filed herein on behalf of the Fidelity & Deposit Company of Maryland as Amicus Curiae. We do this for the reason that that Company does not seem to rely so much upon the same theory as that pressed by Plaintiff in Error in this case, but relies more upon equitable setoff. Under that theory, the apparent contention is that any demand now in the hands of the United States Fidelity & Guaranty Company, Plaintiff in Error, which had its origin prior to insolvency could be used as a setoff in equity,

regardless of equities in others, and regardless of whether or not it arises from the same transaction, and regardless of whether it is mutual within the terms of the principles discussed by various cases directed to the attention of the court in our original reply.

In the first place, we desire to direct attention to the fact that in the quotation made by Amicus Curiae on page 4 from R. C. L., that authority is careful to preserve the contentions we made, in that the principle is recognized that such setoff will be allowed:

> *"Where from the relations and situation of the parties and from the nature of their mutual claims, equity and justice seem to require a complete and speedy settlement."*

In connection with this, it might be well to bear in mind that equitable setoff had its origin from the desire of courts of equity to grant relief where none other existed to avoid multiplicity of suits and to accomplish such results as would be just and fair to all parties concerned, but in doing so, equity has always preserved its principles of equality; regarding that as done which ought to have been done; as not relieving those guilty of bad faith; as requiring those seeking equity to do equity; violating no law and requiring those who seek equity also to come with clean hands.

We have pointed out heretofore that the Surety Company in this case is in the place of the defaulting President of the bank, stands in his shoes, and it

seems to us ought not to have a very high standing in a court of conscience. Undoubtedly, were the funds found in the possession of Norwood, he would be a Trustee *ex maleficio.* If the Surety Company stands in his shoes, why should it be said that it comes with clean hands, and why is it not likewise a Trustee, and why should it not be required to do that which a court of equity would require its principal to do, and not hear him to plead offset against his own misapplication of funds?

It seems to us also that plaintiffs in error confuse their theories somewhat, in that they not only seek subrogation to the rights of the Railway, and through that seek remedies the Railway never had, but also seek through subrogation to have their rights relate back to the inception of the contract when that right does not come through subrogation if it is asserted as an independent offset claimed under equitable principles. We again inquire: Prior to insolvency, what possible right of offset could the Plaintiff in Error have? Obviously none. It therefore seems manifest that Plaintiff in Error is seeking rights as a result of insolvency, which would not exist but for insolvency.

We direct the court's attention to one or two additional authorities pertaining to equitable setoff.

Ruling Case Law, Vol. 24, page 871, Section 78, says:

> "Courts of equity will not generally allow a setoff of a joint debt against a separate debt or conversely of a separate debt against a joint debt;

> or to state the proposition more generally, they will not allow a set-off of debts accruing in different rights, but special instances may occur creating an equity which will justify such an interposition."

We direct attention to two cases from this Honorable Court cited as authority to sustain the foregoing statement from Ruling Case Law, which we deem important in view of the contentions made by Amicus Curiae.

The first of those cases is that of *Dade v. Irwin*, 2 How. 383; 11 U. S. (L. Ed.) 308. The court will recall that there is very little difference between the rule for equitable setoff as applied in courts of equity and that enacted into law by the bankruptcy statute. The opinion of the court referred to was written by Justice Story, who, speaking of the rule of setoff, as applied by courts of equity, says:

> "Now it is clear that courts of equity do not act upon the subject of setoff in respect to distinct and unconnected debts, unless some very peculiar equity has intervened calling for relief; as for example, in cases where there has been a mutual credit given by each upon the footing of the debt of the other so that a just presumption arises that the one is understood by the parties to go in liquidation or setoff of the other."

This applies the principle announced by this court in later cases that there should be at least an implied understanding that setoff should exist, and that the circumstances should indicate such an understanding

rather than repel it, as we endeavored to demonstrate in our original reply.

The second case that we desire to direct attention to is the case of *Gray v. Rollo*, 18 Wall. 629, where this Honorable Court was considering a claim of set-off under circumstances which are accurately indicated by a paragraph of the syllabus:

> "A and B were joint makers of certain notes, which were transferred to an insurance company. B and C held policies in this company which became due in consequence of loss by fire. The Company being bankrupt, its assignee claimed the full amount of the notes from A and B. B sought to set off against his half of the liability the claim due to him and C on the policies of insurance, the latter consenting thereto. Held that this was not a case for set-off within the Bankrupt Act, the two obligations having been contracted without any reference to each other."

It seems to us if the two transactions in that instance were separate, distinct and unrelated, with much stronger reason such would be true of the transactions at bar.

Mr. Justice Bradley in delivering the opinion of the court considers the status of the claims as to being mutual debts and mutual credits in language which we think bears on the case at bar.

> "It is clear that these claims are not mutual debts. They are not between the same parties. The notes exhibit a liability of the complainant

and Gaylord; the policies, a claim of the complainant and his brother. But it is said that by the law of Illinois, all joint obligations are made joint and several; and, therefore, that the complainant is separately liable on the notes, and could be sued separately upon them. Granting this to be so, the debts would still not be mutual. If sued alone on the notes, the claim on the policies, which he might seek to set off, pro tanto, against the notes, is a claim due not to him alone, but to him and his brother. His brother's consent that he might use the claim for that purpose would not alter the case. Had his brother's interest been assigned to him before the bankruptcy of the Company, and without any view to the advantage to be gained by the set-off, the case would be different.

"Nor does the case present one of mutual credit. There was no connection between the claims whatever, except the accidental one of the complainant's being concerned in both. The insurance company, so far as apepars, took the notes without any reference to the policies of insurance; and Gray Brothers insured with the Company without any reference to the notes. Neither transaction was entered into in consequence of, or in reliance on, the other; and no agreement was ever made between the parties that the one claim should stand against the other. There being neither mutual debts nor mutual credits, the case does not come within the terms of the Bankrupt law. If it can be maintained at all, it must be upon some general principle of equity, recognized by courts of equity in cases of set-off; which, if it exist, may be considered as applicable under an equitable con-

struction of the act. But we can find no such principle recognized by the courts of equity in England or this country, unless in some exceptional cases which cannot be considered as establishing a general rule. In Pennsylvania, it is true, set-off is allowed in cases where the claims are not mutual, and, in that State, under the decisions there, it is probable that set-off would be allowed in such a case as this."

(It is interesting to note at this point that some of the principal quotations from authorities relied upon by Amicus Curiae are largely based upon the rule in Pennsylvania, which this court declined to follow in the Gray Case.)

"But we do not regard the rule adopted in Pennsylvania as in accord with the general rules of equity which govern cases of set-off. We think the general rule is stated by Justice Story, in his treatise on Equity Jurisprudence, where he says: 'Courts of equity, following the law, will not allow a set-off of a joint debt against a separate debt, or conversely, of a separate debt against a joint debt; or, to state the proposition more generally, they will not allow a set-off of debts accruing in different rights. But special circumstances may occur creating an equity, which will justify even such an interposition. Thus, for example, if a joint creditor fraudulently conducts himself in relation to the separate property of one of the debtors, and misapplies it, so that the latter is drawn in to act differently from what he would if he knew the facts, that will constitute, in a case of bankruptcy, a sufficient equity for a set-off of the

separate debt created by such misapplication against the joint debt. So, if one of the joint debtors is only a surety for the other, he may, in equity, set off the separate debt due to his principal from the creditor; for in such a case the joint debt is nothing more than a securtiy for the separate debt of the principal; and, upon equitable considerations, a creditor who has a joint security for a separate debt, cannot resort to that security without allowing what he has received on the separate account for which the other was a security. Indeed, it may be generally stated, that a joint debt may, in equity, be set off against a separate debt, where there is a clear series of transactions, establishing that there was a joint credit given on account of the separate debt.' Other instances are given by way of illustration of the principle on which a court of equity will deviate from the strict rule of mutuality, allowing a set-off; all of them based on the idea that the justice of the particular case requires it, and that injustice would result from refusing it; but none of them approaching in likeness to the case before the court. There is no rule of justice or equity which requires that Gray Brothers should be paid in preference to other creditors of the insurance company, out of the specific assets represented by the notes of Gray and Gaylord. If the complainant instead of the insurance company were bankrupt, and the notes were valueless, his brother and the creditors of Gray Brothers would think it very hard if the company were allowed to pay the insurance pro tanto with that worthless paper."

It is plainly observed from this that courts of equity do not depart from the strict rule of mutuality except

on the theory that the justice of the *particular* case requires it, and that injustice would result from refusing it. We submit that injustice in the present case would result from granting it, and justice only results from refusing it.

It seems to us that the reasoning of this court pertaining to mutuality is especially forceful and clearly demonstrates that there is none in the case at bar, and that before an offset can be had, the facts must be such as to appeal with peculiar force to a court of equity, and that where there is no mutuality, the courts have not established any principles which offer a fixed guide in determining how far a court of equity will depart from the rule of mutuality in allowing offsets. But apparently each case must have some peculiar equities which appeal to the conscience of the Chancellor as justifying the departing from the rules pertaining to mutuality. We submit that a frank review of all that was done in the present controversy will show that there is no outstanding and appealing equity in favor of plaintiff in error that should give it the right under equitable principles.

We see no sound reason why the insurance company should avoid its solemn obligation to restore stolen funds to their proper sources, simply because, for an adequate consideration, it acted as guarantor or indemnitor on another and independent obligation. If, in the case last mentioned, the brother and the creditors of Gray Brothers would have occasion for hard thought if the setoff in the supposed case was allowed, what may be said of the suffering creditors in this case

if the setoff is allowed here and the insurance company is permitted thereby to discharge obligations of $48,000 by the payment of $25,000, all of which operates, in the name of equity, to pay off and discharge one creditor in full with funds justly belonging to others.

Respectfully submitted,

Attorneys for Defendant in Error.

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UNITED STATES FIDELITY & GUARANTY COMPANY *v.* WOOLDRIDGE, RECEIVER OF THE NATIONAL BANK OF CLEBURNE.

ERROR TO THE CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

No. 352. Argued April 29, 1925.—Decided May 11, 1925.

1. Where a guaranty company executed a bond guaranteeing the fidelity of the president of a national bank, and another to a depositor of the bank insuring payment of deposits, and the bank thereafter became insolvent through the frauds of the president and the guarantor paid the depositor and took an assignment of the depositor's claim against the bank with approval of the bank's receiver, *held* that this claim could not be set-off by the guarantor as assignee or subrogee in an action by the receiver upon the bond first mentioned. P. 237.
2. The doctrine of relation is a legal fiction invented to promote justice and never allowed to defeat the collateral rights of third persons. *Id.*

295 Fed. 847, affirmed.

Error to a judgment of the Circuit Court of Appeals affirming a judgment of the District Court in favor of the receiver of a national bank in an action against the surety of one of its officers.

Mr. Walter F. Seay and *Mr. Jos. A. McCullough,* for the plaintiff in error.

Upon failure of a bank a depositer may off-set any claim the bank may have against the depositor to the extent of the deposit. The Receiver takes the assets of an insolvent bank as a mere trustee and creditor, subject to all claims and defenses that might have been interposed as against the insolvent corporation. *Scott* v. *Armstrong,* 146 U. S. 499.

A surety on paying the debt of its principal is entitled to be subrogated to the rights of the creditors in all

or any of the securities, means or remedies which the creditor has for enforcing payment against the principal.

The right of a surety to subrogation begins with the contract of suretyship and relates back to that time, and is not simply inchoate until it pays the debt. *Prairie State National Bank* v. *United States,* 164 U. S. 227; *Henningson* v. *U. S. F. & G. Co.* 208 U. S. 403; *Hardaway* v. *National Surety Co.* 211 U. S. 550; *Fidelity & Deposit Co. of Maryland* v. *Duke,* 203 Fed. 661; *Cox* v. *New England Ins. Co.* 247 Fed. 955; *Wasco County* v. *New England Eq. Life Ins. Co. et al.* 172 Pac. 126.

The closing of the bank, the inability of the bank to pay its depositors, the necessity of plaintiff in error's paying the railway company and its liability to the bank because of the defalcation, in reality all grew out of the same transaction, or act, to wit: the embezzlement.

Courts of equity frequently deviate from the strict rule of mutuality when the justice of the particular case requires it; and the ordinary rule is that where the mutual obligations have grown out of the same transaction, insolvency on the one hand justifies the set-off of the debt due upon the other. *Scott* v. *Armstrong, supra; North Chicago Rolling Mill* v. *St. Louis Ore & Steel Co.,* 152 U. S. 594. *Fidelity & Deposit Co.* v. *Duke,* 203 Fed. 661; *National Bank of the Commonwealth* v. *Mechanics' National Bank,* 94 U. S. 437.

A set-off otherwise valid cannot be considered a preference, as it is only the balance, if any, after the set-off is deducted which can justly be held to form part of the assets of the insolvent. The right of subrogation relates back to the time of the contract of suretyship, and not merely from the time that the debt is paid by the surety or actual liability upon the surety is invoked. This being correct, then this plaintiff in error's right to set-off preceded the failure of the bank and of necessity could not be a preference. *Scott* v. *Armstrong, supra.* The

rules of law and equity as to the rights of a surety to subrogation and set-off are not altered merely because the surety was a compensated one.

From the inception of the suretyship relation there is an implied legal obligation on the part of the principal to indemnify and reimburse his surety. This implied promise of indemnity is as effectual as if embodied in a written indemnity agreement executed by the principal at the date of its application for the bond; *Williams* v. *U. S. Fidelity & Guaranty Co.*, 236 U. S. 557; and constitutes the surety a creditor of the principal from the time of the execution of the bond. To regard the claim of the surety against the principal as arising merely through assignment after insolvency of the principal and payment to the obligee is to ignore the debtor-creditor relationship existing *ab initio* between a surety and its principal. *Rice* v. *Southgate*, 16 Gray, 143; *Barney* v. *Grover*, 28 Vermont, 393; *Beaver* v. *Beaver*, 23 Pa. St. 167; *Walker* v. *Dicks*, 80 N. C. 263; *M. Kalin* v. *Bro. V. Bledsoe*, 98 Pac. 921; *Craighead* v. *Swartz*, 67 Atl. 1003; *Allen* v. *Van Campen*, 1 Freem. Ch. 273; *Labbe* v. *Bernard*, 82 N. E. 688; *Dudley Lumber Co.* v. *Nolan Bros.* 156 S. W. 465.

Mr. Ellis Douthit, with whom *Mr. J. H. Barwise, Jr.*, was on the brief, for defendant in error.

Mr. Loren Grinstead and *Mr. Frank T. Wyman* filed a brief as *amici curiae* by special leave of Court.

MR. JUSTICE HOLMES delivered the opinion of the Court.

The National Bank of Cleburne, Texas, became insolvent through the frauds of its president and closed its doors on October 17, 1921. On November 1 following the defendant in error was appointed receiver, and on April

14, 1922, began this suit upon a bond executed by the plaintiff in error on August 28, 1921, binding it to indemnify the Bank for losses of this character to the extent of $25,000. The Guaranty Company pleaded in setoff that on August 24, 1921, it became surety for the Bank upon another bond to the Gulf, Colorado and Santa Fe Railway Company, conditioned upon payment by the Bank to the Railway Company of the Company's deposits in the Bank, and that on January 16, 1922, it paid to the Railway Company $23,312.51 and as matter of law became subrogated to the rights of the Company against the Bank, and in addition took an assignment of such rights, which was approved by the plaintiff on February 1. An agreement of the parties was filed, that the facts alleged were true and that the only question for the Court was "whether or not under the facts alleged, the defendant is entitled as against the plaintiff to set off the demand it holds as assignee or subrogee of the Gulf, Colorado & Santa Fe Railway Company." Thus the answer and the agreement confine the issue before us to the rights of the defendant Guaranty Company by way of subrogation or assignment. The District Court and the Circuit Court of Appeals gave judgment for the plaintiff for $25,000 interest and costs and denied the defendant's right. 295 Fed. 847.

The two bonds were wholly independent transactions and were not brought into mutual account by an agreement of the parties. The Guaranty Company after the insolvency of the Bank could not have bought a claim against the Bank and used it in setoff. *Scott* v. *Armstrong,* 146 U. S. 499, 511. *Davis* v. *Elmira Savings Bank,* 161 U. S. 275, 290. *Yardley* v. *Philler,* 167 U. S. 344, 360. The Receiver contends that that is the position of the defendant here, because it was only a guarantor and was only liable upon the default of the President of the Bank that produced the insolvency. The Court

below treated the claim of the Railway Company against the Bank as acquired by the defendant after the insolvency. The defendant, however, contends that upon its payment to the Railway Company its subrogation related back to the date of its contract; and we will assume for purposes of argument that this is true. But suppose it is, the right of the Railway Company was simply that of a depositor, a right to share with other unsecured creditors in the assets of the Bank, of which the bond now in suit was a part. There would be no equity in allowing the Railway Company a special claim against this bond. We will assume that if the Railway Company had insured the honesty of the Bank's officers the Bank might have offset the obligation of the company against its claim as a depositor. But it is impossible to treat the succession of the defendant to the Railway Company's claim as effecting such an absolute identification with the Railway Company that one and the same person insured the Bank and made the deposits. The doctrine of relation "is a legal fiction invented to promote the ends of justice. . . . It is never allowed to defeat the collateral rights of third persons, lawfully acquired." *Johnston* v. *Jones,* 1 Black, 209, 221.

Judgment affirmed.